International conference on monopolies, mergers, and restrictive practices

Papers and reports
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edited by J B Heath

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Foreword

The conference was held at King's College, Cambridge from Tuesday 23 September to Friday 26 September 1969. It was sponsored jointly by the Board of Trade and the OECD, organized by the Board of Trade, and attended by Ministers, officials, lawyers, economists, and businessmen from the United Kingdom, the United States, Germany, France, Sweden, Norway, Denmark, Portugal, Switzerland, Luxembourg, Japan, Australia, the Irish Republic, the OECD, the EEC Commission and the United Nations.

Its central theme was the relationship between policies on competition, rationalization in industry and economic growth. The formal proceedings took place in five groups working on different aspects of the central theme, with plenary sessions to commence and conclude the conference

That the conference itself was widely acclaimed as being most successful was due in no small measure to the efficient planning and organization of Mr R M Allott, then an Assistant Secretary in the Board of Trade, now in the Department of Trade and Industry, and his staff, and to the work of his Steering Committee.

J B HEATH
November 1970

Contents

Survey of the conference

J B Heath

No reasonably brief survey can adequately reflect all of the contributions made during three days of intensive discussion between lawyers, economists, businessmen and officials about the wide range of issues relating to policies on competition. The written contributions stand as a major outcome of the Conference, and the oral discussions are reflected in the rapporteurs' reports (also reproduced in this volume). However, in writing this survey it was possible to read both the written contributions and the transcript of discussions in the working groups, and thus it became feasible to pool together the main areas of study, arguments and conclusions for the Conference as a whole.

Inevitably, the result is a personal view of the papers and proceedings of the Conference, and another observer might well have written a rather different type of survey. Nevertheless, the objective has been to abstract from the written and oral record those parts which seem to have the greatest significance both for a more complete understanding of the subject, and for the better evolution of policy.

The objectives of policies concerning competition

While the intermediate objectives of competition policy may be expressed in terms of the structure of industry and the market conduct of firms, the ultimate objectives of policy may embrace economic, social and political factors. There was some tendency to think of these ultimate economic objectives in terms of full employment, stable prices, a more equitable distribution of income, rising living standards, a sound balance of payments, and so on. While the implementation of specific policies relating to competition may well have positive effects on the achievement of these objectives, it was not thought that competition policy should be aimed explicitly at such a wide spectrum. This was the task of demand management and of other policy instruments. As Professor Cairns emphasized, there was a danger in expecting competition to do too much, the main objective should be to ensure the speedy and effective transfer of resources from less to more efficient uses. He mentioned that the recent interim Report on Competition Policy of the Economic Council of Canada had seen the main single objective of competition policy as. 'The improvement of economic efficiency and the avoidance of economic waste, with a view to enhancing the wellbeing of Canadians'. It is largely through promoting efficiency and flexibility that competition makes a contribution towards the achievement of macro-economic objectives.

While efficient performance in achieving the optimum allocation of resources—in a short run sense—is certainly important, in a dynamic economy the longer run aspects of efficiency, relating to new product and process innovations, were also significant and could conflict with short run resource optimization. Moreover there were other objectives of competition which were thought to be important in their own right, quite apart from their implications for resource allocation, such as the availability of a genuine choice in the supply of goods and services to potential purchasers

However, Professor Phillips raised a most important difficulty in achieving the efficient use of resources through competition. Individual firms in the pursuit of profits ordinarily do not take account of externalities—those costs on the community (or in some cases benefits to them) which may be incurred through the industrial or commercial activities of an enterprise, but which do not enter directly or indirectly into their profit and loss account. Pollution of the environment is the most obvious example Unless such factors were taken explicitly into account, as would be required in a social cost-benefit analysis, the pursuit of profitability—whatever the state of competition—may well lead to a misallocation of resources. As Professor Phillips pointed out, in a sparsely populated area externalities caused by individuals or by enterprises may impose only small disbenefits on the community, whereas in areas where the population is dense the problem of externalities assumes much greater significance.

Of course the solution to this problem is for the state or some other appropriate authority to impose regulations, or to manipulate decision variables in other ways, so as to bring private and social interests more [illegible] allocation of resources than if externalities were ignored

Mr John Heath was Director of the Economic Services Division, Board of Trade, at the time of the conference.

Regarding the contribution of competition as being strictly limited, nevertheless, if the pursuit of competition policies were expected to have significant effects on the achievement of other Government objectives, then the issue arises whether and how the Government should pay regard to the likely effects on these other objectives of its implementation of competition policy; and vice versa. There is, of course, no greater reason why other government policies should be amended to take account of the objectives of competition policy than should the implementation of competition policy take account of the existence of other objectives of Government. There is always a problem of multiple and conflicting objectives. Thus the 'lapses from competition policy under balance of payments excuses', which Mr Brittan noted, may have been soundly based in terms of the overall costs and benefits to the community at the time. This is not to say that Professor Cairns may not have had a good point in commenting on the danger that in some cases the long run structure of industry may have been determined at least in part on the basis of short run gains to the balance of payments. While the proper answer would be discounting, clearly this requires quantification of all the relevant costs and benefits in comparable terms and in the appropriate time profile.

The scope of competition policy

The scope of competition policy was regarded as being potentially very wide. To a greater or lesser degree, it could be taken to relate to monopolies, mergers, restrictive practices by industry and by trade unions, consumer protection, patent legislation, advertising, refusals to sell, the establishment of companies, copyright law, design law, tariffs, real estate law, transportation law, insurance law, and so on. Professor Bernitz called these collectively 'market law', and identified two fundamental elements: freedom of trade, and freedom of contract.

Freedom of trade itself embraced three elements. First, the freedom of establishment, which implied a basic freedom to enter into a market, to carry on a business activity there, and to decide about the nature of the business, its direction, scope and termination. Secondly, the freedom of competition included, in principle, the freedom to inflict economic injury on competitors; but this gave rise to the need for a further system of rules against unfair competition. What is needed is competition achieving high standards of performance, not competition achieved by hindering others through the exercise of over-riding market power or unfair practices. Finally, freedom of consumption holds that the consumer should have access to comprehensive and reliable information relating to the goods and services on offer.

The resolution of tensions and conflicts between the various aspects of competition policy may be achieved more efficiently if market law (to use Professor Bernitz's term) were to be considered more as a unity. There were many complaints at the Conference that the piecemeal evolution of competition law in the United Kingdom had led to too many institutions responsible to too many Government Departments, so that there was a danger of some confusion resulting. Although new policies in the United Kingdom are agreed ultimately by a single body—the Cabinet—it remains true that much attention has to be paid to proper co-ordination in their implementation. Without a strong sense of unity of purpose, it would be all too easy to arrive at inconsistent conclusions in particular cases across such a wide field.

Regarding market law as a unity, it is apparent that the active implementation of policies towards competition in most countries is somewhat patchy. Thus Professor Phillips pointed to a number of areas in the United States where per se legalities for restrictive arrangements had emerged over time, especially as regards trade union activities, but also in the agricultural and horticultural fields, in the distributive trades and in a number of local practices, such as building codes which favour local crafts and businesses. Many speakers also pointed towards the very limited use that has been made of tariffs on imports in the context of competition policy in the United Kingdom. The tariff is an instrument of economic policy which may serve many purposes, and is not only a counter in international bargaining.

Implementation of competition policy

Several speakers urged that in Britain more decisions in the implementation of competition policy should be made through the application of legal criteria rather than through ad hoc decisions within a rather broad legal framework. As Mr Brittan put it 'the judgement of those who believe in treating each issue on its merits is likely in practice to reflect the fashion or political pressures of the moment'. Moreover, since the identity of decision makers changes over time, this could lead to uncertainties and inconsistencies in in the application of competition policy. This line of reasoning received considerable support, and led to the proposition that in some areas the time had come for the more precise specification of rules of conduct. Sir Rupert Sich (Registrar of Restrictive Trading Agreements) said that he did not think we were yet ready in this country to determine guidelines on which the rule of law could operate concerning information agreements and mergers; we are still in the state of examination and flux. It seemed evident, however, that the Board of Trade had not ruled out the possibility of there being rather more precise guidelines on these matters than existed at present.

In the United States in 1967 the Federal Trade Commission issued its guidelines with respect to mergers in the food distribution industries (described in footnote 33 in the paper by Miss Mary Gardiner Jones), and in 1968 the Department of Justice issued its guidelines for businessmen on mergers. No doubt if guidelines were adopted in the United Kingdom, going beyond the Board of Trade's booklet on mergers,[1] because of the larger element of pragmatism in the application of policy, a somewhat different formulation would be necessary.

There was some doubt, however, whether general *laws* regulating competition could be framed with

[1] Board of Trade, *Mergers. a guide to Board of Trade practice*, HMSO, 1969.

sufficient precision to cover the many different circumstances which might arise in practice, while at the same time affording businessmen clear guides to action. The economic relationships involved were complex and imperfectly understood, so that the achievement of specific economic objectives by setting precise rules of competition could be uncertain. Moreover, Professor Phillips pointed out that even with a per se rule in the United States, which under the Sherman Act declared illegal all price fixing agreements, there was often difficulty in knowing precisely whether there was or was not an agreement to fix prices. But at least having a clear and open judicial attitude towards such agreements did give businessmen a much better guide to action than if each case were to be treated on its merits.

Problems relating to the implementation of competition policy concerning large firms, which tended also to be in concentrated industries, occupied all Discussion Groups to a greater or lesser degree. While the North American attitude was one of attempting to contain their very large firms, to prevent them growing larger, at least through the merger route, with in some cases a conscious desire to see them smaller, the EEC approach was rather to emphasize the positive aspects of competition between large firms, to achieve what Herr Albrecht called 'effective competition'. In a large economy, a range of different firm sizes was needed; in smaller economies conflicts between minimum optimum size and effective competition became more pronounced.

However, in the implementation of competition policy in both the United States and the United Kingdom there was thought to be some imbalance in attitudes towards mergers and towards established companies in a monopolistic situation. In both countries the Government held the power to divorce or dissolve companies in certain circumstances, but there was generally a marked unwillingness to use these powers even where the case seemed strong. Some speakers also thought that there would be a [illegible]

Given the evident reluctance of Governments to enforce the structural change of existing large firms, Mr Sutherland asked whether there was any substitute for structural change. One possible answer was contained in Professor Wilson's paper, where he quoted from the Fourth General Report of the Prices and Incomes Board,[2] in which the Board saw 'an anti-monopoly policy being exercised through the extension into the private sector of the techniques of the efficiency study which we have begun to develop in the public sector'.

The crucial question, of course, is what action would be taken following an adverse report. In general, attempting to prescribe or to regulate the competitive behaviour of firms was seen to be an unsatisfactory alternative to structural change, because some forms of behaviour, such as price leadership, result directly from the existence of a particular form of market structure, or at rate may be facilitated by it. Structural change may have no substitutes. Nevertheless, in the retail trade, especially in the United States, regulating competitive behaviour had proved to be successful (as described later in this survey). Clearly not all forms of behaviour are determined by structure, and these are more amenable to direct control.

One comparatively simple way of changing market structure would be the lowering of tariffs, but in general this instrument was rarely used for this purpose. Certainly it would be much easier and probably less controversial than divorcing or dissolving parts of existing enterprises. It must be admitted, however, that only crude estimates would be possible of the potential welfare changes from the consequent lowering of domestic costs and prices, from the loss in potential terms of trade gain from the unilateral surrender of an international bargaining position, and from any other gains and losses.

There was some discussion about possible conflicts between indicative planning and the implementation of competition policy. If firms were to be invited to discuss their plans for expansion, and to co-ordinate them with some overall national or industry plan, then the acts of joint consultation and co-ordinated decision making would seem to be inconsistent with a policy of individual competitive action in which the more efficient firm would increase its share of the market at the expense of its less efficient rivals. Clearly firms need to have adequate information on which to base decisions, especially investment decisions which have a long time horizon, and some decisions taken in ignorance of the maturing plans of rivals may be wasteful of resources. The question is whether the lack of co-ordination in these types of decision would be more costly to the community (in terms of the rate of return on domestic resources) in the long run than would the reduction of competition which would accompany the attempt at overt co-operation. There is no simple way of finding an answer.

Some specific problem areas in the implementation of policy:

1 THE MULTINATIONAL CORPORATION

Although there have been international companies in existence for 200 years or more, since the end of the 1950s international companies have grown in both absolute and relative importance. They have caused many national governments to ponder upon their effects, especially where governments believe that these companies reduce their power to achieve national objectives. In the implementation of competition policy, in particular, international companies give rise to many difficulties.

It seems clear that there is no a priori reason for [illegible]

Some actions of an international company in the host country may be contributing towa[illegible] ieve of national objectives, while other[illegible] y operate against them. Furtherm[illegible]

[2] National Board for Prices and Incomes, *Fourth General Report, July 1968 to July 1969*. Cmnd. 4130, HMSO, 1969.

may be seen in quite a different light in the host country and in the parent country. Even if both countries were pursuing the same national objectives, the effects in each country might well be different. Considering that most likely both countries would be aiming at sub-optimal welfare policies, looked at from a world point of view, real conflicts of interest are not only possible but quite likely.

Since the effects in the host country may be either good or bad, assessment of the effects of international companies on the achievement of domestic policies—including policies relating to competition—can be based only on a study of the facts. While the principal legal problem in the implementation of competition policy has been extra-territorial jurisdiction (of which more later), in the implementation of domestic policies attention has focused initially upon the size of foreign owned enterprises, and the degree of concentration which they command in particular markets.

In the United Kingdom, for instance, Mr Steuer has estimated that foreign owned firms account for about 10 per cent of employment, about 13 per cent of sales and about 18 per cent of capital expenditure. There are only six industry sectors in which foreign owned firms account for more than 25 per cent of sales or employment. There is some statistical evidence that those sectors of the British economy which have a high proportion of total sales from foreign owned firms also have a high degree of overall concentration in production. Conversely, if it were known that an industry had a low degree of concentration, the odds are 5:1 that the proportion of sales by foreign owned firms would also be small in that sector. However, over the period 1958–63, there was a negative relationship between increases in the proportion of sales by foreign owned enterprises and increases in the degree of concentration of supply. Thus, although foreign owned enterprises appear to favour the more highly concentrated industries in the United Kingdom, the effect of foreign ownership may well be to reduce concentration, initially at any rate.

The United States has the largest share of foreign owned companies operating in the United Kingdom, as in most other countries. Of the 500 largest industrial corporations in the United States, 51 per cent of industrial firms and 12 per cent of the largest merchandizing firms have established subsidiaries in the United Kingdom. Most US parent companies have more than one subsidiary located here. And 45 of these foreign owned firms are amongst the 500 largest UK firms. However, these interesting statistics serve only to raise questions about the effects of these foreign owned firms operating in the United Kingdom.

Mr Steuer is conducting a study of the economic effects of foreign owned firms in the UK on behalf of the Department of Trade and Industry, and it is envisaged that the results will be published. Meanwhile, firm evidence is lacking. Nevertheless, Professor Kronstein provided the Conference with some interesting factual material about the effect of international corporations operating on a vertically integrated basis in the copper and aluminium industries, and he also provided some information about the research activities of international corporations. The real significance of reports of this kind are most difficult to assess without having access to more complete information; nevertheless, the activities of large companies in these fields did appear to give rise to many questions about the benefits which had accrued through subsidiary companies to host countries throughout the world.

Complaints were voiced in more than one group about the problems which the anti-trust laws in the United States created for foreign owned firms wishing to enter that market. Joint ventures seemed to be the most promising route for entry. Furthermore, the rigorous enforcement of the anti-trust laws in the United States, with respect to horizontal and vertical mergers in particular, had led many United States firms to seek expansion by takeover or merger in other countries. Perhaps part of the explanation of the boom in international merger activity by United States companies since the end of the 1950s has been this increasingly rigorous application of domestic policies since the 1950 amendment to the Clayton Act.

But Herr Wertheimer thought that international companies may become less important in the future. This was partly because he saw a decline in the autonomy of the entrepreneur, who would become less of an initiator and more of a mediator between government and private enterprise, and partly because of a shift in economic activity away from the industrial sector. But the growing importance of international enterprises in the non-industrial sector, such as banking, advertising, and even retailing, suggests that even though manufacturing is becoming relatively less important, foreign owned enterprise may not decline with it.

Accepting that the influence of foreign owned enterprises may be either good or bad in the host country, host governments naturally wish to discourage the bad and promote the good. But here problems of extra-territorial jurisdiction immediately arise. The main difficulty is that there may be a need to apply remedies across national boundaries. For instance, subsidiaries may act in accordance with the laws of the host country but contrary to the laws of the parent company's country. Parent companies may require their subsidiaries to behave in ways that are not in the best interests of the host country.

There is initially a problem of information about the activities of international companies. The quality of some information, for instance about inter-firm pricing, is most difficult to assess, and some relevant information may be extremely troublesome to track down. In effect, some companies can escape jurisdiction from almost any country they choose, and full advantage can be taken of the multiplicity of different laws in different countries.

In small countries especially, the activities of international enterprises may assume considerable importance, and consequently their interest in achieving international action is greater. Although there is a multiplicity of different laws in different countries, there are some common elements in approach which may form the basis of international understanding on these matters. Only a few countries have specific laws about mergers (the United States, the United Kingdom and the European Coal and Steel Community),

although most have some powers relating to inter- [illegible]

even though the means of control and the objectives may be somewhat different. The achievement of some degree of co-ordination between countries in the treatment of international corporations will undoubtedly be difficult, but not impossible

Already the OECD has initiated discussions asking for co-operation between member governments, but some of those who were participating in these discussions at the Conference thought that progress was extremely slow. Several suggestions were made that the kind of informal consultations which take place in EFTA seem better suited for dealing with problems of the international corporations as and when they arise. Having some flexibility in the application of national laws concerning competition policy was thought to be an advantage in this respect—it was thought likely to be difficult to make significant progress with the United States government, for instance, because their anti-trust laws have become very clearly defined. The differing nature of national laws con- [illegible]

Mr Davidson put forward the interesting suggestion that some modification of the technique used for the [illegible]

countries in a manner to suit their needs.

Some specific problem areas in the implementation of policy:

2 THE LAW'S DELAY

The desire for quicker (if rougher) justice in the implementation of competition policy by the Mono- [illegible]

Kingdom, which might help overcome one aspect of this problem, was put forward by a member of the [illegible] with experience of the Restrictive Trade [illegible]

same parties or other parties) to the like effect', unless the full procedures of the Registrar and of the Court are re-activated Evidently it was thought that the meaning of the expression 'to like effect' would be refined with experience over the years, so that parties having formerly engaged in registrable restrictive practices would know clearly where they stood In practice this has not occurred. As a result, many firms who had been parties to registrable agreements believe that they have been unduly constrained by such undertakings, sometimes made in quite different circumstances from those prevailing in the present day.

The proposal for a pre-trial conference procedure was that when the board of a company is faced with a [illegible]

Court for breaking its undertaking. While the Registrar of Restrictive Trading Agreements gives advice on many matters, there would be particular problems relating to advice on an undertaking or where the Court had issued an injunction. The [illegible]

pre-trial procedures of some kind, which if they did no more than clarify the issues, might well be of considerable assistance to firms.

Is the market a better judge?

[illegible]

a position to do significantly better; he thought that the Commission in its merger reports claimed too much understanding The issue was posed in terms of the relative competence of the market and of the Commission in judging merger cases, in particular the performance which would be likely to result from the consummation of a merger or takeover.

Although the view was pressed in more than one *Group that the market was well informed and that* the management of the firms concerned were in the best position to judge the likely outcome of a merger, these claims rather missed an important point. The Monopolies Commission is assessing mergers in the light of public interest, in a situation where there could be divergences between the private interest of the firms concerned and the wider interests of the community as a whole. While the market may well make sound judgements about the likely commercial and financial outcome of the merger, although short term—perhaps transitory—considerations may be given too great a weight, that would be only part of the relevant considerations for the public interest. It is not the role of the market to make that extra assessment.

In any event, the stock exchange market is not able *to question the parties about the facts of the case* and about their intentions, so that relevant information may be lacking. And the parties concerned may not be in a good position either where a takeover is con-

tested. Even parties to an agreed merger may not be quite as frank with each other as they would be before the Commission. At least it can be said that the Commission has the opportunity to discover most or all of the relevant facts on which to base their recommendations.

Some general effects on firm behaviour

It was quite evident that in the United States the anti-trust laws have had a most profound effect on the structure and behaviour of firms, especially of large firms. The existence of the anti-trust laws and the way in which they have been implemented has meant that in a very large number of corporations the most powerful man is now the vice-president in charge of their legal affairs. Patent law is important in an anti-trust context in the United States, and Professor Markham made the point that the combined effects of the anti-trust laws and the patent laws had reinforced each other and had had more powerful effects on decision making, especially decisions relating to technical progress, than if each had been taken separately. Professor Turner also felt convinced that the anti-trust laws had had a positively beneficial effect on the rate of innovation in the United States, though he could not prove this assertion. In food retailing Miss Gardiner Jones was also convinced that the anti-trust enforcement programme has been effective and has promoted a healthy competitive structure (evidently the Federal Trade Commission are undertaking an elaborate and careful review of the overall effects at the present time).

The anti-trust laws were seen to be like traffic laws, in that the number of cases for infringement greatly understated their widespread effects on behaviour. In the long run, it was thought that the anti-trust laws provided incentives for firms, in the sense that if enterprises became large they would be protected by the law from takeover (unless they were a failing company, or perhaps unless the acquiring company was a conglomerate enterprise). The laws encourage freedom of enterprise and the development of initiative. By making growth through merger less easy, and in many situations quite impossible, they offer a stimulus to firms to achieve more rapid and effective internal growth, thereby encouraging firms to put their own house in order and to make the best of their existing resources. These incentive effects are perhaps too often overlooked by commentators from Western Europe.

The effects of rapidly rising activity in the administration of the anti-trust laws in the United States, as described by Professor Markham and Miss Gardiner Jones, could clearly be seen in the extremely small number of mergers undertaken by large firms in the United States, and in the decline in the proportion of horizontal and vertical integration mergers in the total. Where all horizontal and vertical integration mergers involving market shares of more than about 5 per cent are likely to be challenged, the effects clearly can be very great. Even conglomerate mergers are no longer free from suspicion, and it appeared that plans are being made to challenge a greater number of such cases in the future. (The desirability of this, however, was open to some doubt, on the basis of Professor Turner's reasoning relating to the chain of processes leading to successful innovation, which is discussed below.) Moreover, the threat of dissolution as a remedy for large firms in concentrated industries is thought to be growing perceptibly, so that the imbalance between the treatment of firms wishing to merge and firms already in a dominant position seems likely to be rectified. And where the penalties for price fixing if the parties are discovered and brought to court can be very large indeed—it is said that the electrical firms who were accused a decade ago of fixing prices have had to pay out nearly one billion dollars in damages, not to mention that several company officials were put in prison—the disincentive against that form of price behaviour is great.

A danger was recognized in the United States position (and only to a minor degree in the United Kingdom) where some firms may have been inhibited from undertaking actions which in fact would not have attracted the attentions of the anti-trust authorities, although the firms believed that they would have done. But the costs of 'anti-trust overkill' may not be very great—evidence of actions that do not take place is difficult to find and to verify—and were thought to be outweighed completely by the benefits.

In Western Europe and Japan, of course, the laws regulating competition are very much less severe, and consequently the impact on the structure and behaviour of firms is less marked. Nevertheless, it was quite clear from many discussions at the Conference that firm behaviour had been influenced both in the United Kingdom and on the continent of Europe by the existence of these laws. In the United Kingdom, Mr Leyland thought that although the activities of the Restrictive Trade Practices Court had had some effect on the growth of mergers, many other factors were involved, including in particular the 1965 Finance Act and the introduction of corporation tax. No one denied, however, that the virtual sweeping away of formal agreements to fix prices had resulted in a healthy effect on competitive behaviour and on performance. In Japan, the implementation of the Antimonopoly Act, as described by Professor Kanazawa, did not seem to have had much effect on the growth of mergers; but this was not for any lack of trying.

Although it was not difficult to point to the number of cases dealt with by the authorities concerned with competition, nor was it difficult to see in what general ways these laws may have affected the behaviour of firms, once attempts were made to study these effects in detail numerous problems appeared. The first is that micro-economic theory itself is unsatisfactory, so that testable hypotheses have to be derived more from ad hoc reasoning than from any fully developed body of theory; yet perhaps Mr Leyland's views in this regard were too pessimistic. No one denies that micro-economic theory is unsatisfactory, but perhaps one of the roads to improvement would be through the careful empirical study of firm behaviour on the basis of the large number of hypotheses which intuitively would seem worth testing. Nowhere are these difficulties more clearly demonstrated than in the area of invention and innovation.

Concentration, firm size, invention and innovation

As many speakers pointed out, innovation is a major factor in the long run growth of productivity. Of all

purchasers, are not easy to discern. Laws relating to competition affect the internal *organization of firms*, their market conduct with respect to competition, their investment and use of resources, as well as the structure of industries. The question then is, insofar as the laws relating to competition operate with regard to these parameters, how has innovation been affected?

Usually one thinks of technological innovation in this context, but Professors Turner and Williamson emphasized that organizational innovation was also

organizations. This had important effects on the size

run cost curve need never turn upwards.

In the United States especially, and to an increasing extent in Western Europe, there have been many studies of a statistical kind in which the broadly based statements of Schumpeter, Galbraith and others, concerning the importance of large firms in innovation, have been tested. While it would be true to say that most of the studies relating to research and develop-

industries do not have an especially good record in invention and innovation in relation to less large firms, the overall impression created by a survey of empirical work, such as that contained in the paper by Professors Turner and Williamson, is that the subject is far too complex to be studied by any simple analytical procedures. There probably is no substitute for the kind of detailed and painstaking work which was well exhibited in Mr Freeman's oral presentation (which, because it went so far beyond his written presentation, and was so striking, has been included in this volume).

Moreover, insofar as valid conclusions do emerge from this increasingly large accumulation of completed research work in the United States, there is

associated with scientific research work in universities.

While the difficulties in transferring lessons from one environment to another are not in doubt, there is a danger in going to the other extreme and regarding North American experience of little or no relevance to European practice. While in many respects the facts will differ, there is a large area in common.

Indeed, basically the analytical approach adopted by Professors Turner and Williamson on one hand, and by Mr Freeman on the other hand, were very similar. Professors Turner and Williamson adopted a

enterprise, or through external transfers between enterprises. Observing actual firms shows that of course both forms of organization can occur. In either event, an efficient means of coupling these activities together was essential to successful innovation.

Dr Hellwig, in his opening speech, emphasized the importance of competition in the research stages and the dangers of settling too soon for a single line of development (his examples were drawn from experience in atomic energy). Where, as is common, the research stages are not heavily resource intensive, then diversity in approach can be achieved where several medium sized or smaller firms are in competition.

Moreover, these medium sized and smaller firms appear to have many advantages in undertaking the initial processes leading to invention, and possibly going through to the production of a prototype product. Professor Albrechtskirchinger pointed out the importance of the social conditions for creativity, and Professors Turner and Williamson mentioned the tendency for large firms to become bureaucratic in their internal organization and behaviour, and to become more conservative over time, the advantage of the smaller firm in this respect is that it is less formal, more flexible and adaptable to changing circumstances. This is especially important when there may be several possible lines of research to be pursued, and where it is important that the controllers of research should be flexible in their attitudes towards new discoveries. Mr Freeman said that some large firms, appreciating these inherent advantages of the smaller organization undertaking the processes of invention, had consciously attempted to simulate the smaller firm conditions in their own organization where research was undertaken.

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chocolate was mentioned, in which chemical engineering firms had launched new processes. The drug industry was also similar in many ways. But he pointed also to metals, glass, heavy electrical engineering, and nuclear reactors as being other clear cases where development costs had become extremely large, and which bore some of the characteristics formerly thought to be unique to chemicals.

Mr Freeman's graphic illustrations of his points provided admirable supporting evidence for the analysis which Professors Turner and Williamson had put forward, and gave greater weight to their general propositions concerning the significance of these developments for anti-trust. Insofar as there were advantages in many industries, in large firms undertaking the later development stages in the stream of processes leading to new innovation, Professors Turner and Williamson thought that takeovers by large enterprises of some of these smaller concerns, which had taken new inventions as far as their financial and managerial resources would permit, was something that should be recognized as being an important factor. In general, the authors thought that conglomerate type enterprises would be the best for taking over these smaller inventive firms (if takeover was indeed the best way of insuring that the transfer processes were efficiently undertaken,) and thus they thought that it might be a mistake to challenge too widely and indiscriminately takeovers by conglomerate enterprises of this kind. But this did not suggest that the anti-trust laws should be modified or weakened in any fundamental way, and basically the authors were satisfied with the laws as they stood.

Successful coupling between the various stages leading to the successful marketing of a new innovation—especially the coupling of research knowledge and of marketing knowledge—could in principle be achieved where all the processes were in the same enterprise. But in this event the other disadvantages already referred to at the invention stage may become important reasons why full integration was undesirable—unless the smaller firm characteristics could be simulated successfully in the larger enterprise. And unless there was a continuing supply of new small firms engaged in the earlier stages of research and development, the marketing of new innovations in the long run might be weakened if too high a proportion of small firms were taken over by larger enterprises. Perhaps there are lessons here for the United Kingdom rather than the United States.

Finally, there was a danger in over-emphasizing the importance of a few spectacular innovations, such as colour television or xerography. While not denying their significance, detailed studies show that follow-up improvements often make much greater contributions to technical progress than do the initial innovations (although, of course, later improvements necessarily depend upon the innovation having been made in the first place). Most of industrial research and development is mundane in character rather than spectacular.

Economies of scale

A considerable degree of scepticism was expressed by businessmen, economists and lawyers in several of the working groups about the existence of significant economies of scale in production beyond quite modest plant sizes, in most industries. While much of the discussion tended to be very imprecise about what was meant by 'large', several speakers mentioned empirical studies which gave statistical backing to their views. Quite apart from the University of Cambridge studies on economies of scale, EEC spokesmen said that their studies showed that for the most part a minimum optimum size of plant did not exceed 4 or 5 per cent of the total market size in the EEC, with only a few lines of production reaching even 10 per cent (which included washing machines, refrigerators, and steel containers).

But, of course, economies of scale in production take no account of the possibility of economies in distribution, and of the minimum optimum size being very large in the later stages of research and development, as already mentioned. Thus it would be dangerous to base a policy relating to the size of *firms* on empirical evidence relating to the minimum optinum size of *plant*. Nevertheless those who have studied American industry in some detail were unanimously of the opinion that European firms do not have to become as big as firms in the United States in order to be able to compete effectively. Professors Turner and Williamson, amongst others, were quite firm on this point.

While acknowledging that organizational innovations have made it possible for very large firms to be viable, the managerial difficulties involved clearly are immense. Furthermore, there were many arguments against allowing firms to be larger than is necessary to achieve all of the significant economies of scale that are available. Quite apart from the obvious factor of competition, a breakdown in a very large plant could have a much greater impact on output than would occur if there had been several smaller plants in existence, with a much lower probability that all would break down simultaneously. Also, a strike at one large plant could have similar effects. Modernization and the removal of obsolescent equipment may be much slower if production is concentrated in very large plants, because it may be more difficult to phase capital expenditure over a period consistent with the availability of financial resources.

The United States experience suggests that there is a danger that management at the top of very large enterprises may come to live in an imaginary world of their own, divorced from the realities of the vast resources which they command.

Thus, while there was considerable scepticism expressed about the advantages of large scale in achieving the more economic use of resources, more industries are demanding large scale as a necessary condition for technical progress, as Mr Freeman pointed out.

The independent retailer

Although the scope for Group 5 included 'other services', in fact discussion concentrated upon the distributive trades, especially retailing. No doubt this attitude was taken mainly because the most lively

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Nevertheless, multiple chain stores clearly have substantial advantages. Miss Gardiner Jones listed many of these at the beginning of her paper, and some clearly had significance in the context of competition policy. The ability, for example, of the large multiple chain stores to exercise countervailing power against large manufacturers, of a kind which was impossible for the small independent retailer, was a significant advantage; moreover, large chain stores might well be significantly larger than some of their suppliers, so that pressure could be exerted to achieve favourable purchase prices, again to a degree which the independent retailer would be unable to match. Occasionally these pressures on suppliers would be reinforced by the threat of the large multiples entering into manufacturing themselves unless their suppliers gave them good prices.

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Two possible solutions were suggested to the problem in Western Europe of the weak position of independent retailers in relation to manufacturers: the introduction of some aspects of the ...

... in the United Kingdom), and structural change, especially through voluntary groups. By forming groups of retailers round a wholesaler, the independent retailer could gain some of the benefits of favourable buying power of the multiple chain store, without losing his independence through merger. This had become widespread in the Netherlands, Germany and the United Kingdom, and was on the increase in France.

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Resale price maintenance

Resale price maintenance has long been illegal in the United States. In Canada it was prohibited in 1951, although the practice of specifying resale prices ... manufacturers ...

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firms selling grocery products that had formerly practised resale price maintenance had made substantial changes after its abolition. These included cutting out the wholesaling stage, reducing the number of price lines, and generally changing marketing methods and production programmes. On a basis also of relative changes in gross margins the abolition of resale price maintenance could be seen to have had some effect.

Nevertheless, Professor Skeoch also made the point that in the distribution sector—as presumably in other parts of the economy—the effects of even the best designed and implemented policies concerning competition may be greatly weakened through poorly designed or administered policies in other sectors. In the context of distribution, although the banning of resale price maintenance had had observable effects in stimulating competition, its weakness was that if mergers are permitted in this sector which are not warranted by real cost and dynamic considerations, or if tight oligopolies are permitted to employ discriminatory pricing practices which support the established methods of distribution and discourage innovations, then the potential contribution from the ban on resale price maintenance would be seriously limited. M. Houin argued in the same way, that banning resale price maintenance was of little value unless refusals to supply were also prohibited. In other words, as Professor Bernitz had pointed out, market law should be considered as a unity, the various parts being consistent and supporting each other.

In the United Kingdom, the effects of the ending of resale price maintenance have not been studied in detail, but in the experience of Sir Hugh Weeks, price competition has been little affected except in a few areas, including spirits, electrical products, paint and tobacco. He thought that, although the ending of resale price maintenance was a sensible decision, the effect has been rather less than might have been expected. But other close observers of the scene thought that Sir Hugh had underestimated the effects. However, the virtual banning of resale price maintenance in this country has resulted in two other issues achieving greater prominence: recommended prices, and refusals to supply.

Recommended prices

The practice of recommending prices probably has greater significance for competition where there is a high degree of concentration in supply or distribution than where concentration is low; and of course much depends upon the level of price recommended. Recommended prices are legal in the United States and Canada as well as in this country (although the Monopolies Commission in a recent report on the subject thought that the practice needed to be watched by the Government to observe its development and effects).

One development observed in the United Kingdom has been the tendency for some manufacturers who did not previously attempt to maintain resale prices now to recommend prices so that retailers could then mark them down to indicate a bargain sale. In the United States this practice of 'pre-ticketing' was once widespread, but is now prohibited and has been virtually eliminated. In Canada, however, while the legislation on recommended prices was thought to be better than in the United Kingdom, extreme cases can still arise (as where a fountain pen with a 25 dollar recommended price was advertised for 98 cents). Moreover, as already mentioned, in Canada there has been a tendency for manufacturers to represent recommended prices as though they were the actual prices to be charged. Evidently in France there is also a problem of the excessively high level of many recommended prices.

The possibility of abuse through retailers giving a false impression of what price a manufacturer had recommended for his product—hence giving a false impression of the discount offered—is dealt with by prohibitions in precisely the same way in the UK, under the 1968 Trade Descriptions Act, as in France. A difference arises, however, where the discount is made by reference to a price at which such goods were previously offered. If the price of a product had been artificially raised in order subsequently to be able to offer a discount, this practice, designed to mislead purchasers, was thought to be not adequately covered by the UK legislation (which requires that the higher price must have been offered for a continuous period of not less than twenty-eight days within the last six months); whereas in France M. Houin, who is responsible for the application of this area of policy, said that the amount of the discount is assessed by reference not to a previous price but to the retailers' purchase price plus the profit margin normal for the trade. The UK legislation came in for some criticism in this regard.

Refusals to supply

The OECD Report on this subject was thought to be the best 'recommended reading' on the subject at present. In most countries in Western Europe and North America refusal to supply was seen as an important instrument by which manufacturers could attempt to maintain their resale prices, and generally where there was legislation against resale price maintenance there was also legislation against refusal to supply. In Britain such provisions were written into the 1964 Resale Prices Act, with an exception where dealers have been using the goods as loss leaders (at present the Monopolies Commission are investigating refusals to supply, and how successfully this part of the Act has worked). In France the law is unambiguous that refusal to supply is prohibited, although again there are exceptions. For instance, it may be admissible if a retailer is not in a position to supply certain services which are indispensable to the retail sale of the product in question.

In Canada, in the 1960 Amendments following the earlier ban on resale price maintenance, refusal to supply was admissible only in situations where products had been used as loss leaders, or if distributors had failed to supply adequate servicing facilities for the products concerned. But under Canadian law, suppliers can cut off supplies to retailers if they think that either of these two circumstances exist, and then it is up to the retailer if he wishes to complain to the

'Director of Investigation and Research' before an investigation would begin.

In the United States, the attitude is that once a manufacturer has decided upon the type of retail outlet which will handle his product, he is not then entitled to control what the retailer does with the product, in terms of prices, customers or territories to be supplied. Thus there is some limited right to refuse to sell, but Miss Gardiner Jones expressed the view that its dimensions were very unclear. If a manufacturer refused to sell because of price cutting activities by the retailer, or if there was any suggestion of collaboration between the manufacturer and other distributors, then such cases would not be accepted. In the Chevrolet case, for instance, the Supreme Court held that if there were overtones of price fixing in a refusal to sell, then this kind of boycott would not be permitted.

Price discrimination

Although the Robinson–Patman Act in the United States was much criticized, and had led to some curious results, nevertheless on balance it was thought to have had a good effect on competition (but this also was the subject of current study in the Federal Trade Commission). Its importance is indicated by the fact that approximately one quarter of the resources of the Federal Trade Commission are used in its administration

This law against price discrimination was an attempt to cope with the discriminatory buying advantages which the large national supermarket chains were able to obtain over the smaller local independent retailers The Robinson–Patman Act prohibited price discrimination where the effect might be substantially to lessen competition. The law condemns both the giver of such discriminations, as well as the recipient when he induces them. Exempted are discriminations which are given in good faith to meet the equally low lawful price of a competitor, and discriminations which are based upon differences in the cost of serving the favoured and unfavoured customer. The law also condemns as illegal brokerage payments when they are a fictitious charge rather than a charge for actual services performed.

In the administration of the Act, two types of injury to competition have been identified: the 'primary line', being injury to other suppliers caused by price discriminations so deep and so repeated, and business activities so aggressive, that this behaviour goes beyond the bounds of hard driving business tactics; and 'secondary line' injury to other customers who do not receive the same benefits of favourable price cuts where the favoured customer would be given a substantial advantage over his competitors. Although the criteria for alleged discriminatory discounts are very strict, the implementation of the law has given rise to much criticism from economists, lawyers and businessmen, as described by Miss Gardiner Jones; and while there seems little doubt that the benefits of the price discrimination laws have exceeded their costs, exactly how beneficial this area of competition policy has been is not yet known.

The United Kingdom has no legislation on price [illegible] number of other speakers from the United Kingdom thought that there was a case for having some version of the Robinson–Patman Act in this country.

[illegible] in two of which legal proceedings were recommended but not undertaken, there has been no real experience in administering the price discrimination law.

Non-price competition

An expanding area of competition policy in many countries relates to the non-price behaviour of retailers, and to the whole area of consumer protection. Policy in the United States, well summarized by Miss Gardiner Jones, has been to remove the trade restraints and deceptions which are inherent in some of these forms of non-price competition and their practice, and to see that small businessmen are not disadvantaged by such forms of promotional expenditure. And the Federal Trade Commission increasingly were trying to ensure that the consumer receives sufficient information in order for him to be able to purchase [illegible] and to recognize quality. There is little incentive for a quality manufacturer to enter the market unless he [illegible]

In this respect policy developments in the United States and Western Europe are closely in parallel The Federal Trade Commission, for instance, on a pilot basis at present, is requiring affirmative disclosures of octane ratings for petrol (as is the practice in the United Kingdom), and of the effective life of electric light bulbs

United States policy concerning trading stamps is aimed essentially at increasing the options open to retailers to use them competitively. There was a high degree of concentration in the companies issuing trading stamps (five companies accounting for about [illegible] gage more in price competition. It is interesting to note that in the United Kingdom trading stamps tend to be used perhaps more by the smaller retail outlets than by the multiple chain stores—the reverse position from that in the United States.

The implementation of competition policy concerning games of chance used as a promotional device in retailing, which are a much more prevalent form of

non-price competition in the United States than in western Europe, has been directed towards requiring the detailed disclosure of the odds of winning—another interesting example of the way in which consumer protection is moving.

Discriminatory behaviour in advertising and promotion, which gives the large enterprise substantial advantages in advertising rates and in obtaining favourable treatment from press and television media, in the United States is also directed towards ensuring that smaller retailers are not disadvantaged. Proportional equality in rates is required to this end, and the Federal Trade Commission has issued several guides, rules and statements elaborating their policy in this respect.

Other services

In the context of the United Kingdom, Sir Hugh Weeks did not think that there was a case for applying the 1956 Restrictive Trade Practices Act to services such as banking, where he thought that the Bank of England and the Treasury together would be able to act more quickly and efficiently. Charges made by architects and solicitors have been referred to the Prices and Incomes Board, and the activities of estate agents to the Monopolies Commission. The only issue of importance he thought was the determination of the scale of fees, and the general conclusion from investigations is that the scale of fees determined by a professional association should either disappear, cease to be mandatory, or should be determined by some outside body. He did not think that further action would be necessary.

M. Clement thought that the absence of competition in services generally in France was a worrying situation, but unfortunately this view was not elaborated during the course of the Conference.

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Opening speech: 1

The Rt Hon C A R Crosland, PC, MP

I am very glad to welcome you all to this conference. From the beginning, we have set out to make this not only an international conference, but also an 'inter-disciplinary' one—a conference, that is, at which are represented all the professions which need to concern themselves with the problems of monopolies, mergers and restrictive practices. The list of participants shows that we have succeeded beyond expectation in both of these aims.

I should like to thank the OECD for agreeing to act as joint sponsors of this conference with the British Government. In particular we are very grateful to the Secretary General, Dr Kristensen, for agreeing to take the chair at this opening session. This is a fitting reflection of the valuable work done in OECD over the last ten years in promoting a better understanding of the issues which the conference will consider, and in providing a forum in which officials can discuss these issues as they arise in the various member countries. I am delighted also to have with me on the platform Dr Fritz Hellwig, Vice President of the European Commission, and Mr John Davies, Director General of the Confederation of British Industry. The European Economic Community is unique in that it is the only [illegible] too, no doubt, to those of us in Government—to hear from Mr Davies this morning and from other speakers from industry in the various working groups later in the conference, how the business looks on competition policy.

We have been very fortunate in the range and quality of the papers which have been produced for this conference, and I should like to thank all the contributors for the hard thought and hard work they have put in. These papers contain an abundance of [illegible] ery Office will find this a very rewarding commercial venture.

I should also like to thank the Provost and Fellows of King's College for making it possible to hold the [illegible] Thanks to them, I am sure that the few days you spend here will pass pleasantly, as well as productively.

When the preparations for the conference were still at an early stage, one of my first requests was that it should not be referred to as an 'anti-trust' conference. I did this—at some cost in convenience in all subsequent correspondence, I am told—because the words 'anti-trust' are too closely connected with one particular approach in one particular country. Until the end of World War II, legislation to regulate the acquisition and exploitation of market power in the private sector was confined to the United States. Indeed, in many other countries in the 1930s cartels received positive legislative encouragement.

But today, few advanced industrial countries are without some form of regulatory legislation on monopolies and restrictive practices, while the supervision of company mergers is also becoming increasingly widespread. Some developing countries, notably India, are moving in the same direction. At the same time, international agreements now often make provision for the control of private market power, where this is required by the objectives of the agreement. The authors of the Treaty of Rome, for example, saw rules of competition for the private sector as an integral part of an economic union; the Stockholm Convention also includes provisions on this subject. In both cases, it was believed that the exercise of market power could seriously diminish the benefits which were expected to flow from the removal of tariffs and other barriers to trade.

In all the countries which have legislated in this field, the motive has been the concern of public opinion about the concentration of power in the hands of a single enterprise or group of enterprises. But this concern has not always been felt for exactly the same reasons. In some countries more weight has been given to the social implications, while in others the emphasis has been on the economic implications. The first approach sees the great social, and even political, power which can be wielded by large companies or groups of companies—a power which is not subject to democratic control as is the exercise of comparable power by local and national governments.

The second approach—a concern with the econo-

The Rt Hon Anthony Crosland, PC, MP, was President of the Board of Trade at the time of the conference.

mic effects of large concentrations of market power—can trace its ancestry back to classical economics. No doubt, as this is Cambridge, several members of this audience could tell me in which chapter of his *Principles* Marshall reached the conclusion that in conditions of monopoly too little will be produced at too high a price. More recently, attention has shifted—certainly in this country—to the dynamic advantages and disadvantages of concentrations of market power—for example, whether in a particular case greater economies of scale will or will not outweigh the weakening of competitive pressures.

Thus, the 'social' concern is directed towards the size and power of firms in relation to the communities of which they form part, while the 'economic' concern is focused on the relationship of market power to the efficient use of resources. Now in a country as small as Britain, the social and economic arguments could lead in different directions. For, in some industries, it may well be that the efficient use of resources can be achieved only by a firm large enough to have great social and political significance. So we could pursue a thorough-going anti-trust policy—by which I mean having legislation to restrain the emergence of companies large enough to wield great social or economic power—only at a considerable cost in economic efficiency. That is why we have adopted an essentially pragmatic approach—we have accepted, and indeed in some cases encouraged, the formation of very large companies, but we also have legislation designed to prevent the abuse of market power. Thus, our legislation does not presume that a particular degree of monopoly or size of merger is against the public interest; to that extent it is neutral—though it can be strict, once a thorough enquiry has established actual or likely damage to the public interest. But it does presume that certain types of restrictive practice, which usually have the effect of protecting inefficiency, are against the public interest.

There have been previous international conferences on the same subject as this one—notably in Chicago in 1958 and in Frankfurt in 1960. But these were mainly concerned with the legal aspects of monopolies and restrictive practices. As far as I know, this is the first such conference at which governments, businessmen, economists and lawyers have all been represented. And it comes, I think, at a particularly appropriate time, when technological progress and the gradual removal of trade barriers are not only lending a new dimension to the subject, but are increasingly creating a situation where similar problems recur in different countries. For example, recent discussion of conglomerate mergers in Britain has been full of parallels with the similar debate which has been going on in the United States. Again, one of the most striking developments of the past decade has been the growing importance of the multinational company, and the increasing incidence of trans-national mergers or take-overs. According to one much-publicized recent forecast, the number of manufacturing groups in the whole world in twenty years' time will be no more than 300. This may be an exaggeration but the mere fact that such an idea can be entertained illustrates vividly the direction in which events are moving. Such multinational companies will naturally consider the whole of the environment in each of the countries in which they operate, or might operate, when they plan their future investment programmes. This creates a new set of problems for national governments, and not just in the field of competition policy. In their choice of economic policies generally, they will have one eye on the policies of other countries which offer alternative locations for the investment of the multinational companies.

Partly as a result of these increasingly rapid developments, intergovernmental consultation and co-operation in this field has taken on a new urgency. Work on international restrictive agreements has been going on in OECD for some time, and work on mergers and the multinational firm will shortly begin. The United Nations Conference on Trade and Development is already studying how the developing countries may be affected by these trends.

The subjects of this conference are therefore of the greatest topical interest. My own immediate concern is of course with the contribution which the conference can make to intelligent governmental policies. All policy and legislation in this field are founded, implicitly or explicitly, on some economic theories and some theories of company behaviour. If government policies are to achieve their desired results, these theories must be sound.

It is essential, therefore, that current theories should be subjected continuously to searching critical examination. It is with this in mind that we have devised the subjects for the five Working Groups of the conference. We have also tried to ensure that competition policy will be approached from as many points of view as possible—government policy, company behaviour, industrial structure, international aspects. And we have tried to ensure that every type of professional concern, practical as well as theoretical, is as far catered for as possible.

As chairman of each of the five Working Groups we have secured the services of a senior official concerned with the administration of national—and in one case Community—policy. This arrangement, as well as ensuring that our discussions are not unduly slanted towards the experience of any one country, reflects the intention that the proceedings of the conference should be of direct practical value to governments.

I should now like to say a few words about each of the Working Groups; and about the issues which I, at any rate, as the responsible Minister in a country with fairly comprehensive legislation in this field, hope will be illuminated.

I hope that the first Working Group will discuss policies to regulate monopolies, mergers and restrictive practices in the context of economic policies generally. The British Government, and I suspect it is not alone in this, has sometimes been accused of pursuing conflicting economic and industrial policies through a variety of institutions and agencies. Is there in fact any general tendency for legislation on competition to cut across the other objectives of economic policy—for example, the promotion of industrial efficiency or a healthy balance of payments? If so, is this inevitable?

A related question is the form which legislation in this field should take. On the one hand, industrialists

demand legislation which is sufficiently flexible to allow for the great diversity of business situations; on the other hand, they demand greater certainty and say they must know where they stand. 'Flexibility' suggests legislation with a good deal of administrative discretion for the authorities; 'certainty' points to a court procedure, with the issues for decision spelled out in detail. The former makes possible a closer co-ordination with other government policies, but may on occasion lead to a suspicion of arbitrariness; the latter possesses a more obvious objectivity, but may give rise to conflict between the various objectives of government policy. There is scope here for much fruitful discussion, and I look forward to being one of the beneficiaries.

The second Working Group will be concerned with the effect which legislation on these matters has on the behaviour of the individual firm. By this I do not mean simply the direct effect—the fact that if the law prohibits price fixing, then on the whole firms will tend not to fix prices. I mean also the more interesting and important side effects—the possible distortions in company behaviour which, some people suggest, are caused by certain types of legislation in this field. For example, in this country it has been suggested that our strict law on restrictive practices has encouraged mergers between companies which previously co-operated in ways not now open to them. The rather similar suggestion has been made in the United States that the stringency of the law on horizontal mergers has been one of the main causes of the rapid growth of conglomerates. Again, it would be valuable to have some comment on the suggestion that laws against restrictive practices may inhibit some forms of co-operation between firms which would be economically beneficial.

The third Working Group will be concerned with the impact of policies in this field at the level of the industry rather than the firm We want expert views on whether differences in industrial structure can ever be traced, even in part, to differences in legislation. The question might be illuminated by comparing the structure of the same industry in different countries, or different industries in the same country. From there we want to see how far the dynamic efficiency of an industry can be related to its structure, and whether it is possible to generalize about the extent to which large scale brings economies, and how far it either stimulates or retards innovation—particularly interesting questions when some fashionable ideas about size are now beginning to seem rather naive. This Group will also want to examine the implications for industrial efficiency of the growth of conglomerates.

The fourth Working Group will concentrate on the special factors which arise when policy in this field is considered in an international context. What problems may arise from applying national legislation to multinational companies? Is the location of investment, and of research and development, likely to be significantly influenced by the character of competition policy in different countries? This is clearly a matter of great importance to Governments. Related to this are the legal issues of jurisdiction which arise over applying legislation to non-resident companies; and questions about the effects of international cartels, of how and whether to apply national legislation to them, and of whether, in the longer term, international action is feasible. In particular we need [illegible]

Typically, government policy on monopolies and restrictive practices is concerned with the behaviour [illegible]

quality, reliability and proper standards of profes- [illegible]

policy But we are, after all, meeting in the college of the great Professor Pigou, who always insisted that economics was worthy of study, not so much for the light of pure knowledge which it shed, but for the fruit of practical results which it might produce. And so we hoped even more that the conference would be of real practical value to governments and industry at a time when, in almost every other country, these subjects are arousing a growing interest and concern. The level of the attendance and the quality of the papers suggest that our hope will be realized It only remains for me to wish you all a most stimulating and enjoyable conference.

Opening speech: 2

T Kristensen

It is very appropriate to hold this Conference at the present juncture. Since the last Conference in 1960 much has happened that should influence our thinking about government policies concerning mergers, monopolies and restrictive practices.

Since OECD is co-sponsor of the Conference, I might say a few words about the problems as they look from the point of view of an international organization.

Economic growth has been spectacular during the last decade but it has been accompanied by an inflation which has become stronger and more widespread during the last few years. This is due to the fact that demand has been kept at a high level leading to a high degree of utilization of productive capacity, including the labour force.

Such a general economic climate obviously strengthens the market power of both trade unions and enterprises so that competition is diminished in most markets. From 1958 to 1968 internal prices in the major OECD countries have on the whole increased three times as much as export prices, which clearly indicates that the internal markets have been exposed to less competition than foreign trade in spite of the gradual abolition of internal tariffs in the EEC and EFTA. That should make us reflect on the enormous contribution to the control of market power we could obtain from a world wide abolition of trade barriers and from an economic policy that avoids overheating.

Another feature of the last decade has been the well-known technological progress which has both strengthened and weakened market power. It has strengthened it in favouring the creation of larger enterprises or collaborating groups of enterprises. It has weakened it in creating a large number of new products and new models of existing products such as motor cars, etc. so that consumers can choose among an ever larger number of new and fascinating things on which they can spend their money. The enormous amounts spent on publicity show that competition is very alive in a number of fields.

A third phenomenon that has characterized the last decade is the increasing internationalization of business. When a big firm has subsidiaries in many countries it is hardly possible for the national authorities of the individual countries to control its operations effectively.

Mr Thorkil Kristensen was Secretary-General of OECD at the time of the Conference.

These developments clearly have an influence on the way in which the problems facing monopoly control authorities present themselves. At the same time a fuller understanding of the real nature of monopoly and competition seems to be gaining ground. It has been under way for a generation but progress has been slow.

It is now more than thirty years ago that a distinguished Cambridge economist, Joan Robinson, published her book, highly appreciated by experts: *The economics of imperfect competition.* Almost at the same time an American economist, Edward Chamberlin, published a book on roughly speaking the same subject with a still better title: *The theory of monopolistic competition.* This title clearly indicates that in the typical market situation of modern industry monopoly and competition go together. There is not something black called monopoly or something white called competition.

Ford Motor Company has a monopoly of Ford motor cars but it is in lively competition with other motor cars and, indirectly, with many other products that attract people's attention. Therefore it must engage in publicity. Recently there was in the *Financial Times* an advertisement by British Ford Motor Company, covering a whole page. It contained an enormous portrait of the Chancellor of the Exchequer and a text telling the public how much the activity of Ford Motor Company had done to help the Chancellor to solve the economic problems of this country.

In fact, the strenuous efforts of the modern industrial producer to create for himself a particular image in the eyes of the public shows that competition today is more active than in the old days. Under the so-called free competition—which was, by the way, never as common as often believed—the individual producer cannot influence the market. His role is rather passive. He must accept the existing price and can only decide how much he wants to produce at that price.

By contrast, modern competition is active and often aggressive. The individual producer fights to maintain his share in the totality of the markets competing for the consumer's money. The word monopoly is therefore, as normally understood, misleading. The producer is never alone.

This does not mean that he can have no *market power.* If one day all the big motor companies were merged into one it would have more market power

than Ford or General Motors have today. It would still have to compete with railways, sea and air trans- [illegible]

new models every year.

I mentioned this theoretical example—though I wonder how theoretical it is—because it throws light on the central theme of this Conference; how can we keep market power under control without doing harm to rationalization and economic growth?

Behind the current trend towards big business, through mergers or otherwise, there is a mixture of two motives. Let us call them the *high price motive* and the *low cost motive*. If we could reduce the first and let the second play its full role we would have the best of both worlds How is that possible? I hope this Conference can give a contribution to answering this crucial question

It is closely connected with another question that has played a certain role in the discussion about monopoly control: should authorities try to control [illegible]

It is clear that the more operations can be con- [illegible]

place where it is strong enough.

This reasoning therefore leads us to another crucial question: can we effectively control the *operations* of the giants of today?

Those who work in the control business know better than most people how difficult it is to obtain a true picture of the complicated operations of a large industrial concern, perhaps working in many countries It is a question of getting all the relevant information and then it is a question of penetrating economic analysis

These two sides of the problem are, of course, closely linked. The more refined our methods of analysis are, the better do we know how to ask the right questions about the information we need

I shall not go into the details of economic analysis at the enterprise level. Permit me only to quote a famous Danish poet who was asked to make a state- [illegible]

to the art of economic analysis

The other side of the question, that of getting all the relevant information, has been put into a new perspective by the internationalization of business that I just referred to. In the case of the multinational enterprises the picture one gets by asking for information about operations in one single country is very imperfect. What is worse, there may develop a competition between countries corresponding to the competition in offering tax havens to big companies or havens for flags of convenience to shipowners

If such an international concern discovers that in a certain country control of market power is weak or inefficient it will be tempted to have as many of its operations there as possible. Or it may manage its own internal price system in such a way that it earns very high profits in that country and therefore can show lower profits in countries where control is sharper.

This raises yet another crucial question which I think this Conference should consider very seriously: if those to be controlled are becoming more and more international will not control itself have to be progressively internationalized too?

Opinions differ on the juridical justification of extraterritorial application of national anti-trust laws The best way to solve such a problem would, of course, be by international agreement This would not be an easy task but it would, in principle, not be much different from agreements concerning the question of double taxation.

If the giants of industry are increasingly to have a world-wide network of subsidiaries it would seem that it will be a hopeless task to get a real picture of their operations necessary for control without international co-operation which would permit the authorities of various countries to give one another some of the information they have collected

It should also be considered if, and then under [illegible]

Opening speech: 3

F Hellwig

When my friend, President Eberhard Günther, asked me to speak at the opening session of this very admirable International Conference on Monopolies, Mergers and Restrictive Practices, I first had a moment of hesitation. This was not only due to the difficulty of fitting this into my list of engagements, a difficulty which I foresaw and which has not been entirely solved. My main concern was to see if there was anything I could contribute to your discussions without repeating what has been said much too often before, and also without being too elementary for this highly specialized audience. There was, too, the consideration that in the Commission of the European Communities I am not directly responsible for the field covered by your International Conference. I therefore should like to start by stating that I am only going to put forward some personal views which are, it is true, the result of observations in my present field of work—that of general research, technology and nuclear research—but which are not the official views of the Commission of the European Communities.

Economic growth is a more or less definite aim of economic policy in all our countries. The sources which feed economic growth are, however, not the same everywhere. Here, we can observe a shift which is becoming increasingly evident, in the countries of our Community as elsewhere. Up to the beginning of the 'sixties', economic growth rested quite substantially on a steady increase in the labour force. This was accompanied by a rise in productivity through rationalization in the broadest sense of the term. For some years the expansion of the labour force has been slackening progressively. In some countries, particularly in the Federal Republic of Germany, expansion has even given way to stagnation, and the recruiting of foreign workers has not been a completely effective alternative. It is probably safe to say today that the medium and long-term economic development of industrialized western Europe will also take place against a background of very limited growth in both population and labour force. In other words, the main source of economic growth in real terms will no longer be an increase in population or labour force, but advances in productivity and improvements in the structure of production. As the difficulty of the situation came to be understood, it has increasingly been recognized that improvements in the structure of production offer, over and above advances in productivity, a further possibility for ensuring economic growth.

Dr Fritz Hellwig is Vice-President of the European Commission.

Advances of productivity and improvements in the structure of production belong to the classical methods by which enterprises can hold their own in competition. Their efforts have always been supported by governments, mostly in a form that has been neutral in its effect on competition. The far-reaching structural change in the world economy and the increased importance of productivity and the structure of production for the future of economic growth have introduced new aspects in the continuing process of adaptation. Here I am referring not only to the political aspect which arises from the increasing public interest in this process. I feel that today the time factor, too, has gained considerably in importance. This has led to a dilemma which I want to describe in some detail in the light of the experience gathered in some of our countries.

A competitive economy requires that firms shall stand the tests to which they are exposed both today and tomorrow. Where is the firm that will not hold over a decision to ensure competitiveness in the years ahead, slow down the execution of research and investment projects which will not make an immediate contribution to competitive strength, or at least reduce the funds available for them when the sharpness of competition today makes it necessary to throw in all reserves? This is indeed a source of danger that is latent in a competitive economy. A colleague from the High Authority of the ECSC once described it as follows:

> Under our system of competition firms are unable to earn what it takes to finance long-term tasks. This calls for concentration to reduce the number of competing decision centres. Finance can be provided for the next twenty years when there are six firms, but not when there are several dozen.

This comment, even if it overstates the case, reveals the dilemma facing the entrepreneur who has to choose between immediate and longer-term survival. Now it would be an over-simplification if a number of erroneous decisions to opt for immediate security were put down to this dilemma. Opportunism, inefficiency and human weakness too often lead to a situation where, in an effort to maintain the status quo, resources are employed which in the longer run would be much better used to strengthen one's competitive position for tomorrow and the day after

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Structural adaptation to the new production and market conditions would be easier if the resources needed to cover the requisite research and development and new investments were not already being used to maintain unprofitable, i e. non-paying lines.

Now I do not intend to put down to this dilemma the technological leeway which is so often deplored. The heavy risks of financial large scale research and development must be seen in connection with the economic fragmentation of Europe, with its effects in the form of the preservation of small national markets, technical obstacles to trade, outdated economic and regional structures and the inadequate scale of production units and companies.

The often described and not very happy picture which our economy offers as a result of the sins of the past can be expressed in a brief formula: people are wondering whether the industrial countries of Europe, once the cradle of the industrial revolution, will in *the longer run be able to compete with the new in*dustrial super-powers. This raises the further question whether the competitive economy itself is still able to make optimum use of the forces which must be mobilized if competitiveness is to be maintained in the future. Behind this question there is, of course, the fact that technical progress and economic growth are also being aimed at under economic systems where competition as the governing principle has been more or less completely eliminated When discussing the interrelationship between technical progress and economic growth on the one hand, and the competitive economy on the other, we cannot avoid the question as to the relationship between the entrepre- [illegible] the State. We [illegible]

between private business and governmental activities varies from one country to another. And some of the difficulties which we come up against in the search for multilateral co-operation in research and development are the result of these differences in the relative positions of private business and public authority.

The classical concept of competition started from the assumption that the unhampered play of the forces of competition was the best means of promoting economic development, and was thus at the same time the best motor for technical progress This concept has held true for a long time and even today the economic growth of the western world is largely based on the dynamism inherent in competition.

In our economic surroundings there is, however, one field—a field that is assuming increasing importance—which seems to be developing largely uninfluenced by market forces. I am referring to sectors where there is as yet no direct or discernible demand on the market or where the market is largely unable to play its role because of the nature of the product. The former applies to products which are not even known yet and for which demand must first be developed. The latter is true of sectors of research and of large-scale projects for which governments are virtually the only possible initiator or buyer.

It is true in this field of research and development that there is a long-established division of labour between government and industry. The government has looked after basic research, while private industry has developed products to the point where they could be put on the market. This division of labour rests on the principle that what has been paid for from public funds should not go to individual firms but be made available once again to the public.

Major technological developments of the past have already benefited from government support—and here I am thinking not only of the State's military interests, but also of other political objectives, such as changing the social structure or ensuring that the country shall not be dependent on others for its supplies of important raw materials. In addition to these reasons for government intervention there is more and more often the fact that the lead-times involved make the risks of private investment in research and development so great in some industries that the State is brought in to share them, and a whole *new scale of government aid has resulted. On the* subject of these risks, a few figures will illustrate the sums needed today for research and development: the annual overall cost of an engineer in the Federal Republic of Germany is currently about DM120,000 (US$30,000 or £12,500). A medium-scale development project requires the services of 100 to 200 engineers, while for a larger project an average of 700 to 800 engineers is required.

In this connection it is also interesting to have a look at the minimum turnovers which the manufacturers of certain products must achieve nowadays if they are not to vanish from the market. In data processing an annual minimum turnover of DM600m ($150m or over £60m), is considered necessary, and in electronic components DM500m ($125m or over £50m).

These technological requirements mean inevitably that in certain industries such as data storage, microelectronics, traffic control systems, reactors, plasma physics and superconductors, only the giants can be competitive today At the same time this means concentration and a reduction in the number of competitors There is consequently pressure to reduce competition in such industries, but this is partly offset by the fact that the products manufactured in them compete with each other on the world market.

The investments which are required for the development of products of high technological content are therefore so massive, the entrepreneurial risk is correspondingly so great and profitability achieved only after such a long time-lag, that these projects are nowadays subsidized by governments in practically every country of the world—whatever its economic system. As individual firms would not be in a position to tackle such projects, the State acts as pacemaker.

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economic growth on the one hand, and the competitive economy on the other, we cannot avoid the question as to the relationship between the entrepreneur and economic intervention by the State. We need not even go as far as thinking of the radical differences between East and West Even in our own countries, for instance within the EEC, the relationship between private business and governmental activities varies from one country to another. And some of the difficulties which we come up against in the search for multilateral co-operation in research and development are the result of these differences in the relative positions of private business and public authority.

The classical concept of competition started from the assumption that the unhampered play of the forces of competition was the best means of promoting economic development, and was thus at the same time the [illegible]

In our economic surroundings there is, however, one field—a field that is assuming increasing importance—which seems to be developing largely uninfluenced by market forces. I am referring to sectors where there is as yet no direct or discernible demand on the market or where the market is largely unable to play its role because of the nature of the product. The former applies to products which are not even known yet and for which demand must first be developed. The latter is true of sectors of research and of large-scale projects for which governments are virtually the only possible initiator or buyer.

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These technological requirements mean inevitably that in certain industries such as data storage, microelectronics, traffic control systems, reactors, plasma physics and superconductors, only the giants can be competitive today At the same time this means concentration and a reduction in the number of competitors. There is consequently pressure to reduce competition in such industries, but this is partly offset by the fact that the products manufactured in them compete with each other on the world market.

The investments which are required for the development of products of high technological content are therefore so massive, the entrepreneurial risk is correspondingly so great and profitability achieved only after such a long time-lag, that these projects are nowadays subsidized by governments in practically every country of the world—whatever its economic system As individual firms would not be in a position to tackle such projects, the State acts as pacemaker.

Of course it is not always for purely economic reasons that governments place certain large-scale contracts and distribute subsidies lavishly. The motive is often a mixture of economic considerations, national prestige and a desire to be independent (example: the

SECAM television system). Some projects, for instance, are undertaken at home though the products can already be made better or more economically abroad.

Such decisions make sense if they ensure that available capacity is fully utilized or that carrying out the work within the country makes it possible to keep up with technological developments in other countries—for example: the airbus.

But this practice involves the danger that a domestic industry receiving government subsidies works in an artificial, competition-free atmosphere and is as a rule carefully protected from foreign competition by the government itself. Experience teaches us that an industry supported too heavily for purely political considerations finds itself only too easily in a state of crisis as soon as it is exposed to the chill wind of international competition.

The economic losses arising from such artificial isolation are often considerable. There is the danger, furthermore, that on account of the priority given to prestige projects important collective needs are neglected. While mistaken investment in the private sector leads only to the bankruptcy of a firm, wrong decisions taken by the State can lead to political difficulties in a country and be a burden on its budget for years.

One example, drawn from Euratom's work, may explain this. For years, Euratom's research programmes have been criticized on the grounds that several competing lines of development were being financed in the field of power reactors. We have discussed this point with the electricity industries in our countries again and again. More and more the idea has been gaining acceptance—and is supported by the electricity industry as our customer—that it is more economical at the research stage to go ahead for a time with a number of competing projects rather than to settle too early for one line of development and stick to it for years for reasons of prestige. The development by the French atomic authorities of gas graphite reactors, which have now been given up as not being competitive, undoubtedly cost many times as much as has so far been invested by Euratom in competing lines of research.

It is not to the advantage then of a country's prestige to persist with a project merely because the prestige of the project's sponsors in the bureaucracy is tied up with it.

A rational attitude is that a constant watch, international as well as national, should be kept on results and that timely adjustments should be made when lines of development are untenable or unprofitable. In the case of power reactors to which I have referred, the electricity industry, in other words the customer, insisted that in the prototypes being developed by the State unprofitable lines should be abandoned.

Even where the State does not undertake research and development itself, the play of competition is threatened by the danger of other forms of intervention. I refer in particular to the policy of government aids and the influencing of co-operation between firms.

For a variety of reasons government aids have increased considerably in recent years. In Germany and France they went up between 1964 and 1967 by 35–40 per cent. With the removal of customs barriers and increasing integration, aids supplied in one member state have an increasingly marked effect on the economy of its partner countries. The various forms of aid are, it is true, an important means of helping firms to carry out readaptation measures, but in an economic community it is indispensable to harmonize the measures taken in the several countries if competition is not to be distorted, if the choice of location is not to be uneconomic and if one member state is not to outbid the other in the aids it offers; in other words, competitive subsidization has to be avoided. We must avoid a situation in which individual States pursue policies which lead to competition between budgets instead of competition between firms.

Co-operation between the industries of our member states has not been developed very far in the field of research and development or production. In view of the considerable degree of commercial interpenetration within the Community it is surprising that up to now there have so seldom been mergers or acquisitions of holdings across national borders.

The difficulties of commercial law and tax law which are often mentioned cannot, however, be held to be solely responsible. More and more frequently the reason is rather the direct or indirect intervention of the State, as when the French Government raised objections to Fiat's acquisition of holdings in Citroën.

Similarly, the German Government intervened in the negotiations for the sale of shares of Gelsenkirchener Bergwerk to the Campagnie Française des Pétroles, with the result that the block of shares was eventually sold to Rheinisch-Westfälische Elektrizitätswerke, thus remaining in German hands.

Following this increasing trend towards nationalization in recent years, some governments have instead tried to strengthen the international competitiveness not only of smaller firms but also of bigger ones and even of very large companies by encouraging mergers *within* national borders.

Their aim is presumably to retain national sovereignty over important parts of the economy—sovereignty which may well be lost to governments as trade barriers come down.

These developments involve serious risks, particularly for the uniformity of competition law, to which the Rome Treaty ascribes so much importance as an integrating factor.

The integration of the former separate markets of each country into one large common market certainly creates new elements to be considered in assessing the effect of concentration on competition.

As long as the pressure of competition from other Community countries—or from non-member countries as tariffs are dismantled—increases, we shall have nothing to fear from mergers within each of the domestic markets. They may even be necessary, in order to keep the balance needed for maintaining competition in a given country as powerful firms from other countries make inroads into its market. But if individual governments exert an influence on these processes, there will be a growing risk that concentration will not primarily be a means of adjusting to the requirements of market competition but that in the

various countries new forms of production and marketing will emerge which are shielded against the effects of competition If and when dominant market positions are thus created in our member states,

[illegible]

attempt to influence the government's trade and economic policies The consequences are serious not only for the market economy but also for the economic and political integration of Europe.

If business interests take on a political aspect, there will be the danger of competition between firms escalating into competition between nations. Co-operation agreements could then easily develop into political votes for or against a given country. Success in gaining a share of some market in another Community country would easily be looked upon as a sign of expansionary tendencies on the part of the successful country. It seems, then, that it is just as difficult to adapt Europe's economic structure to international competition and to make the fuller use of Europe's economic capabilities as it is to overcome national differences

[illegible]

concentration within national bounds under government protection This would not only hinder the further process of integration but would also widen the technological and managerial gap between Europe and the United States.

Where technological advance and the business risk involved call for the amalgamation of firms which are already big, we should endeavour to encourage the formation of European trans-national corporate groups, because this is more likely to result in workable competition than if semi-public combines are set up in the different member countries.

When we speak of government promotion of research and development, we are often thinking only of certain areas of advanced technology in which a substantial degree of concentration has in any case been reached already. It cannot be stressed often enough that official promotion of research and development ought also to have regard for the traditional structure of industry in the Community For our ability to compete on world markets does not depend solely on large firms in certain advanced industries but also on a multitude of small- and medium-sized businesses, among which there is still keen competition coupled with a remarkable vitality reflected in continuous rationalization and innovation There is no direct link between propensity to innovate and size of firm American experience has shown that smaller businesses are quite capable of making a contribution to technical advance As competition grows keener, there is pressure on firms of all sizes to innovate in respect of both processes and products, although it appears to be greater for the smaller firms, as their size does not allow them to spread risks between different activities within the one organization

For the Community, then, it is increasingly urgent that action be taken in company law, tax harmonization, patent law and even more in the removal of technical barriers to trade, if we are to have a legal infrastructure that will enable firms to prepare themselves for the large common market that is emerging by setting up branches abroad, or by merging or otherwise co-operating with firms in other member countries.

Co-operation as a means of increasing performance and competitiveness is not yet practised by small and

[illegible]

certainly due largely to the traditional habits of smaller businesses and the short time that has elapsed since Community markets began to knit together Another factor is the uncertainty of firms about what types of co-operation are permissible under the Community's competition law.

To remove this uncertainty, the Commission has already taken a number of important decisions on individual cases and has issued a definition of the kinds of business co-operation which are not caught by the ban of the Treaty.

These include, subject to certain provisos, agreements on the exchange of information, joint R and D and joint utilization of plant not accompanied by other arrangements.

However, the measures of co-operation which *do* fall under the Community's rules on competition are more important to companies One of the most urgent tasks of the Commission is now to make clear what is lawful and what is not in these areas A number of test cases have produced decisions that provide certain boundaries between what is permissible and what is not in the fields of specialization, joint research and development and joint purchasing These decisions show that the Commission will be liberal in issuing exemptions in these fields

In addition, the Commission is preparing to grant block exemption for certain forms of co-operation to exploit the results of joint research, and for agreements on the use of uniform standards and types.

You all know that co-operation at European level has already been organized for numerous research and development projects. I do not want to speak here of the individual projects and the problems they raise from the angle of their effectiveness or of their inclusion in the competitive order of the Common Market. Nor is it a secret to say that we have come to a dead end with a number of projects, notably because it has not yet been possible to solve some of the conflicts I have referred to before. As, however, we examine the individual projects and the problems they raise, it is increasingly being realized that Community policy should concentrate less on individual projects and more on the common order which the Common Market must develop not just for the industries we have around us, but for the industries of tomorrow We will not really have understood what is involved in the task of making economic integration a solid basis for everyone's future if we failed to endow the Common Market now with uniform rules of competition We have for instance, only scratched the

surface of the mountain of technical obstacles to trade that still burdens the structure of industry today. But we are already being threatened by a multitude of new technical obstacles to trade which are developing in the so-called advanced industries. I therefore wish to make it absolutely clear that the Common Market must be endowed with an infrastructure for research and technical development which is neutral in its *effects on competition. It is essential that this infrastructure should provide for*:

(i) Non-discriminatory access to new technical knowledge. European information and documentation centres, programme libraries and data banks are indispensable if the constantly increasing flow of new scientific knowledge and technical know-how is to reach even the medium-sized and small firms.
(ii) Development of uniform measuring techniques and nomenclatures.
(iii) Development of European, if not international, standards for components of all types, and development of a European reference standard for materials. We do not want to leave this field to big business because in their hands company forms and standards could be just another form of restrictive practice.
(iv) Standardization of the regulations governing health protection and technical safety in the fields covered by the new technology. Example: the uniform Euratom standards for protection against nuclear radiation.
(v) Harmonization of the main forms of government intervention, particularly where subsidies, public contracts and tax concessions for research and development are concerned. As a first step, action has been taken to confront the current programme in our member countries.

I should like to end my contribution here. I do not want to give prefabricated answers to the questions raised. Our Communities have, as I have hinted a number of times in what I have said, not yet found such answers to all the questions. Whether they are found and translated into rules that are binding within the community will depend on our degree of economic understanding and would at the same time involve a political tussle with the governments of the member states. In saying this I am not criticizing any particular government or administration. The position is simply that integration has reached a point where the national institutions, which have until now enjoyed a monopoly of policy-making power, are faced with the question whether a part of this policy-making power is to be handed over to the institutions of the Community. But it is important that the existence of the problem should first be realized. A first step could be that, given the basic rules of the competitive economy, the State should recall its proper role, which is not that of a competing party but that of an arbiter and watch-dog for the maintenance of our competitive order. In practical terms, and applied to the fields of research, technology, the advanced industries, etc., this means that in view of the tendency inherent in technical development for the State to step up its involvement, there should be growing consciousness that in each of the individual developments there is a point where the institutions of the State or the community will have to decide what is more important: the maintenance, and so the expansion, o governmental participation and intervention in this development, or the maintenance of the broader principles of our economic and social order, which is based on the principle of competition. In other words, those exercising public authority must, in the interest of freedom, be ready or even be forced to give up steadily expanding power positions in favour of the competitive economy.

Opening speech: 4

J Davies

The purpose of this conference is a constructive one. We are all here to contribute elements of our own national experience in these crucial matters both for self-enlightenment and, no less, to give some sense of direction to future policy in these fields. The fact that it is an international conference has a further significance in that, with the continual dismantlement of trade barriers, the need for some harmony between nations in their future policy in these fields becomes more and more evident.

It will be the task of the individual groups to analyse and dissect the conditions and needs of individual parts of the overall problem, and I will not endeavour to encroach upon their areas of discussion. It seems to me that my rôle is far more to suggest some broad lines of thought which might form a framework within which their discussions might evolve. I am far indeed from boasting that the framework I suggest should be adopted as an appropriate one, but rather am I concerned to put forward some thoughts on these crucial topics which, together with those of others, may be hewed into a more or less acceptable shape. I start with the belief that this whole topic, as most others, cannot be ventilated as a self-enclosed one. It has to fit into a wider framework of policy as concerning the development of industry and national and international prosperity as a whole.

Let me put forward two general considerations which seem to me the essential foundation of any reflection upon these matters.

First that the pursuit of profit by the individual on his own account or for the advantage of those for whom he is a trustee is generally desirable and constitutes the main pillar of capitalist society.

Second that the aggregation of profit achieved by countless individuals in this pursuit produces that accretion to total wealth which is, in one way or the other, a principal objective of national or international policy. I do not say 'the principal objective' for it too must be reconciled with parallel objectives of political, moral, cultural or other consequence. But I do say that the accretion of wealth is no less considerable an objective than are the others. I reject any presumption that where there is a contest between, say, material and political objectives the latter has some natural right of preference.

These considerations lead me to the conclusion that restraint of the individual from his pursuit of profit must be positively justified and not acceded to for

affirm to be generally desirable. I do believe it to be important to insist upon this point: so often in recent years I have been involved in discussions which presumed that other objectives were naturally preferable to profit objectives. I have heard it said that the extension of trade unionism was preferable to the achievement of profits: that the balance of payments should have the advantage of them: that public expenditure was to be preferred to them and thus justify ever heavier corporation taxation: that the development of advanced design had merit over-riding profit considerations: and so on. I do not by any means seek to aver the converse case—i e. that the profit objective over-rides all others—but I do strongly insist that adjudication either way needs justification and that, where there is doubt, the bias of advantage should be given to the search for profit.

I now turn to another very general consideration. We are all rightly concerned to ensure that the pursuit of profit is not carried on to an extent which damages others who have no means of counter-action. Here again our whole subject revolves around the protection of people inadequately equipped to protect themselves whether by defects of their knowledge or ability, or by those arising from the inadequacy of the law. But we need to be careful about over-doing it There are at least three good reasons for this.

First, because any method of restraint we adopt seeks to replace the judgement of one party intimately

Second, because excessive protection has disturbing

Mr John Davies was Director General of the Confederation of British Industry at the time of the Conference.

results in the sense that those protected develop less and less capacity to protect themselves. If we want a competitive society we must ensure that the customer efficiently develops his critical judgement and does not get to rely to an excessive degree on official vigilance on his behalf.

Third, because interventionist actions stultify management. No matter where, official screening is ponderous and time-wasting. As time goes on the individual search for profit itself becomes inexorably more complex and more competitive. It is important not to load more than necessary those involved in the search with non-productive tasks.

From these introductory thoughts I draw two general principles which should be present in the minds of those concerned with policy formation in the fields we are considering: policy should lean towards a preference for not restraining the individual from the pursuit of profit; and intervention to shelter potential victims of abuse should err on the side of too little than too much.

Pursuing my declared theme of viewing the generalities rather than the specifics, I am led now to look back and then forward and trace, as I see them, the ways in which public policy has evolved in its attitude to the pursuit of profit.

Up to the time of the last war—in this country at any rate—there was no doubt that public policy was mostly concerned with the creation of conditions in which the pursuit of profit was largely encouraged. As contrasted with conditions today there was little intervention to shield the victim or potential victim be he shareholder, customer, employee or the wider community as a whole. External trade policy was largely the projection of the short-term needs of the pursuers of profit without much regard to the national interest—whatever that is: taxation and economic policies sought a position of neutrality: employment policies were concerned with mitigating excessive hardship rather than with intervening in the employment process: control of goods and services offered sought solely to obviate the more obvious abuses generally of a physical rather than an economic nature. Only where the pursuit of profit was seen blatantly to offend humanity or the physical amenities was there any real effort at restraint. Safety at work; abusive use of young or female workers; defilement of the country; these and like matters were beginning to be the subject of regulation, but that was about all.

Since the war there has been here in the UK a continuing flood of official intervention in the uncontrolled pursuit of profit uncovering layer after layer of possible damage much of it as much a matter of surprise to the potential perpetrators as to the potential victims.

The customer. Whilst maintaining and intensifying the restriction of physical abuse, official policy has undoubtedly more and more accentuated the need to ensure the elimination of exploitation of the customer economically. Logically enough distinctive policies have emerged, served by distinctive institutions, to deal with the overt threat of bigness as contrasted with the covert menace of restrictive agreements exemplified in cartel arrangements. For the former the control mechanism is a permissive one armed only in the last resort with powers of compulsion: for the latter a legalistic form buttressed by a special court of law has been devised. Where the threat is seen to arise not from the present structure but from a rapidly evolving re-structuring process, special adaptation has been made to the permissive mechanisms reinforcing the empirical character of their activities and consistently avoiding the pitfalls and rigidity of fixed quantitative criteria. Where the restraint has been envisaged as a counterpart to a parallel intervention in the evolution of earnings under the so-called Prices and Incomes Policy, a new permissive mechanism has been instituted, occasionally reinforced with ultimate compulsive powers: in the field of the abuse of the customer the economic justification for such an activity has always seemed a good deal less convincing than the political one.

The employees. It is not surprising that a generation which has seen a veritable revolution in the State's intervention in employment policy should also have seen an awakening of interest in the impact on employment prospects of the pursuit of profit carried to its ultimate conclusion of re-structuring or monopoly. Policy has brought about profound, humane and overdue changes in the impact of misfortune arising from employment or the absence of it. The equivalent concern for the deterioration of employment prospects arising wholly from external causes has been late coming and perhaps masked by the alleviation of the intense hardships which previously existed. It is, however, true to say that late realization has hitherto caused much debate; some exhortation but, as yet, little interventionary action. Undoubtedly one of the reasons for this is that the employment prospect of any individual is a continuing process geared to the whole progress of the enterprise. There may be identifiable turning points, but they are not necessarily coincidental with re-structuring or monopoly.

The shareholder. Apart from the most obvious restraint of arbitrary impositions by majorities upon minorities provided by company law, there has not been until quite recently in the UK much concern about the impact on owners or part-owners of the unfettered pursuit of profit by others. Recently, however, there has been intervention on two separate scores. One concerns the ability of those who are privy to the whole detail of an enterprise's circumstances and intentions to achieve profit at the expense of their own partners in the enterprise and third parties by manipulating the enterprise particularly in the acquisition of another or others. Voluntary codes of practice have been established in this field reinforced by sanctions to be imposed not by the central authority but by responsible organizations.

A second field of action has latterly been engaged in circumstances where it was judged that existing access to information by the owners was inadequate to allow them to arrive at a valid judgement of the merits of a proposed merger.

The creditors. Little need has been seen latterly to strengthen action in order to protect this class of in-

terested party against depredations caused by the unfettered pursuit of profit. Some increase in the body of information required to be published in compliance with company law has taken place ostensibly for the benefit of creditors, but in reality more to satisfy the interest of governmental busy-bodies.

The management. Here again there has been little concern to intervene in the defence of management against damage caused by the relentless pursuit of profits. It is still an unanswered question whether the company's interests as an entity should be pursued by management in despite of evidence that the owners' interests would be best served by the pursuit of a less than optimum policy. As to career prospects the management is in no different position from the employees generally.

The community as a whole. The pursuit of profit as the individual sees his best interest is a constant subject of intervention on this score. In physical and environmental terms: in balance of payments terms both in investment and trading considerations in regional development terms: in terms of the national interest in efficiency: in terms of national self-sufficiency. For these and many other reasons means have been found to modify the apparent intentions of individuals to comply with a central assessment of the national advantage with lip-service, but no profound regard paid to the international consequences

It is particularly in this rather heterogeneous area that there is clearly a want of a real strategy, The na- [illegible]

means substantially diminishing a traditional industry. The nation wants more industrial investment but not if it is the Midlands and the South-East. These contrasts are, of course, somewhat unjust, but they do serve to highlight the uncertainties which brood over so much of the pursuit of profit and emasculate the pursuers.

With apologies to our overseas visitors I will endeavour to draw what I have had to say into some general conclusions applicable to our UK situation They are deliberately framed not to be specific and to be easy to reject, but they represent my own balance of judgement on the issues involved.

The customers

1 The institutions should be simplified into a single one with an advisory rôle and an abbreviated process.
2 The present empirical policy both as to monopolies and mergers should be preserved in this context.
3 The law concerning abusive and restrictive agreements should be preserved but administered where necessary by the general courts.

The employees

1 Consultative mechanisms between employers and employees should be strenuously propagated. 'Employers' should mean the representatives of the owners as well as the salaried management.
2 A much more active labour market policy should be undertaken by government drawing in on a local basis employer, employee and DEP representatives.
3 Worker membership of Board of Directors as a valid means of handling the problems involved is an illusion

The shareholders

1 The voluntary methods of take-over control and applicable sanctions should prove equal to the need to restrain abuse.
2 Considerable improvements in information provision to shareholders are required Directors representing the interests of shareholders should report separately from the management on company performance and in merger cases both to 'taker' and 'takee' shareholders.

The creditors. No change.

The management. Except where there is a sole owner, individual or corporate, management should be required to report any actions taken by the company contrary to optimum objectives

The community as a whole

1 There should be preserved those areas of intervention where there is an identifiable national interest—e g regional equilibrium.
2 Where there is not such an identifiable interest the fundamental causes provoking intervention should be tracked down and remedied.

If shareholders do not get the information and guidance they need from their representatives to make valid decisions then the law should be changed to ensure that they do

If institutions do not exist privately to draw profit from improving industrial structure then the reasons for such non-existence must be discovered and overcome.

If intervention is undertaken in international capital movements to bolster up a balance of payments weakened by domestic economic policies then the latter must be changed and the intervention removed

In maintaining any general approach to this whole problem I have, of course, over-simplified particularly in outlining future policy. I make no apology for so doing. My endeavour has been to put forward an outlook· a philosophy which seems to be sustainable I believe that laissez-faire is no policy for the '70s, but nor is excessive regulation. The '80s will no doubt need something different again.

Part 3

Conference papers

Group 1
Objectives of economic policy–the contribution of policies on monopolies, mergers and restrictive practices

1.1 Chairman's report

E Albrecht

[illegible]

have been expressed.

This Working Party was asked to examine the [illegible]

[illegible] anti-trust policy is only part of a complex legal and economic method of organizing our economy and indeed our society. The Working Party began by pointing out that the market economy, with free enterprise, freedom of choice for consumers, workers and entrepreneurs, is particularly well matched to our general political system of Western democracy: this is what our American friends have often called the con- [illegible]

[illegible]

[illegible]

which the consumers prefer. Competition facilitates the optimum allocation of scarce resources. Where there is competition the economy adapts quickly to changes in prices and other economic variables, and technological progress is likely to be exploited swiftly. All this means greater efficiency.

We then proceeded to consider the relationship between the contribution of competition and macro-economic objectives, and following Professor Cairns we took into consideration as objectives full employ- [illegible]

[illegible]

other factors, particularly aspects of macro-economic policy, were the factors that really counted. It was [illegible]

[illegible]

under conditions of at least acceptable price stability, while avoiding balance of payments difficulties. In so far as this latter aspect of the balance of payments is concerned, one might say that the efficiency of an economy is not without some bearing in the international comparison which is the basis for the flow of [illegible]

[illegible]

is the case for macro-economic equilibrium which is covered by other policies—short-term economic policy, monetary policy. There are important factors governing growth that cannot be left to the free play of competition, this is true, to take just one example, for education and occupational training. It was made very clear by some of our speakers that the problem of external or social costs cannot be solved just by establishing competition on the market, and Professor Phillips in particular stressed the growing importance of these external costs—pollution of the air and other factors—in an economy in which population density is steadily growing and technological progress is steadily gaining momentum. Professor Phillips has gone so far as to suggest that competition policy is

Herr Ernst Albrecht is Director-General Competition, European Economic Commission

increasingly irrelevant because of the growing importance of the factor of external costs, but I think during the discussion we reached an agreement that in fact we need a policy in both fields. We all would like to have an efficient system of competition to coordinate the micro-economic process, but we agree also that our Governments should pay particular attention to the problem of social costs, pass appropriate legislation forbidding certain industrial practices, making appropriate charges for others, and perhaps also trying to reform our tax system in such a way that external costs become internal costs for the industries concerned. A very important factor of application of this principle is the field of regional policy, and it was recognized by all of us that in order to have satisfactory local conditions and harmony in the development of the different parts of our territories we have to have a regional policy to supplement competition policy.

Our Working Party also considered whether there might not be fields in which competition policy could be harmful to our economies. The first, obvious, point was that sometimes, when a declining industry becomes non-competitive, the market mechanism might provoke disruption leading to local redundancies, and it has been recognized that governments have to do something about this.

Now you could handle this problem in different ways. You could give subsidies to the industries concerned, but if our policies are to be consistent, subsidies should not be indefinite, they should be tapered gradually down, and there should be a plan for the reconstruction and adaptation of the industry. But there is also the possibility of providing for 'gateways' in competition legislation—'crisis cartels'—in order to allow for these situations. I think we have some slight differences of opinion as to what instrument we prefer in this field; however, it has been recognized, and I think agreed by all of us, that if you accept the crisis cartel one has to make sure that the change wanted really is brought about and that it is not just a device for maintaining the uncompetitive existing situation.

It was also clear that the principle of competition might conflict with certain sociological policy goals. If you want to keep enough people in farming, you might well have to curtail competition, or if you want to promote independent small and medium-sized firms, as some of our Members States do, this might lead to some exceptions from the principle of competition, exceptions which inevitably diminish the efficiency of any economy.

The most important aspect, to my mind, of the discussion was the debate on the very object of competition policy—greater efficiency. It was pointed out in the Working Party that sometimes competition policy can actually hamper the pursuit of greater efficiency. Competition can make it more difficult for industry to trim costs, and yet we feel that competition policy must promote efficiency.

The Working Party did not consider in detail the technical requirements for maximum efficiency or the real relationship between size and efficiency, because we felt that this should be left to Working Party III. But we did want to emphasize that two points might be of interest in this context, the first one being that it is very important to define competition. As Professor Kaldor put it in our Working Party, 'What do we mean by competition?' If you try to protect in all markets perfect or polypolistic competition, you might have some difficulty in reconciling this policy with the requirements of technological progress and optimal production conditions. If, on the other hand, you are satisfied with what we call 'workable' or 'effective' competition, if you accept competition between large corporations, if you accept a certain type of large oligopoly, then you will find that the pursuit of efficiency and the need to promote competition are less likely to clash.

It has also been pointed out that the geographical scope of our policy is not irrelevant to this problem: that when we have a national market of, let us say, 50 million consumers, there might be a number of industries comprising only one, two or three really efficient modern companies. When you have a large market of 200 or 250 million you might have eight, ten or twelve companies competing in a single industry, so that the conditions for the maintenance of effective competition are better. The Working Party has been aware of the fact that there are two ways of taking this fact into consideration: either by applying legislation to a sufficiently large market—this is the case in the United States of America and in the European Economic Community—or if you cannot do this, you should lean heavily on international trade to reconcile your requirements of size and technical efficiency with the need to maintain effective competition. We regretted that the tariff instrument is mainly considered as a bargaining instrument between our states and therefore is for the time being of little use for competition policy.

Mr Chairman, we discussed a few other topics I would like to comment briefly upon. Firstly, pursuing the idea of anti-trust policy being a part of a wider economic and legal system, we thought that we should ask ourselves how one should devise and implement a coherent economic policy. Professor Bernitz has considered this problem from the legal point of view, and from an economic point of view reference was made during our work to the attempt made by the European Economic Community to integrate all specific policies such as industrial policy, regional policy, competition policy, into a coherent 'medium-term economic policy'. I cannot go into detail at this point, but one might say that this is an effort all our governments must make; certainly there has been much to learn from the various contributions made in other countries. I may add that we have been aware of the relevant institutional problems: we had an interesting and lively discussion mainly between our British colleagues, Professor Wilson and Mr Brittan, the representative of the Board of Trade and the Department of Economic Affairs, upon the merits and disadvantages of the variety of government agencies existing in this country, such as the Monopolies Commission, the Restrictive Practices Court, the IRC and the Prices and Incomes Board. The Working Party felt that it was not our task to discuss the particular legislation and administrative machinery of one country, so I will not comment upon this particular British issue,

but we definitely felt that all our countries in one way or another are faced with a similar problem and that we should try to ensure sufficient co-ordination, and arbitration if necessary, between the different agencies or departments of our governments.

I might add that this morning we had an interesting discussion about the relationship between competition policy and indicative planning. As everybody might expect, there were differences of opinion on this [illegible] of whether it might be in conflict with competition policy or not.

The last point I would like to raise is that great concern has been expressed by some of us, and particularly by Mr Brittan, that the rule of law be maintained in the field of anti-trust policy: Mr Brittan felt that the law sometimes is not sufficiently precise, that too little justification is given for important decisions and that in the field of competition policy too much discretionary power might exist. Here again, the Working Party did not want to discuss British policy in particular. Generally speaking we agreed, however, that an attempt can be made to elaborate some- [illegible] Germans and the European Economic Community have issued guidelines concerning co-operation agreements between firms. It has finally been noted that decisions on test cases might be useful to establish and maintain the rule of law, if explanatory statements supporting judgements are sufficiently detailed. But it remains a fact, emphasized on several occasions in our [illegible] economic judgement cannot be avoided and there are lots of cases where per se rules are just not possible.

Mr Chairman, that is all I have to say except to thank Her Majesty's Government for having given me an opportunity to take part in this conference and to thank you, Mr Chairman, ladies and gentlemen, for your attention.

1.2 Competition policy and economic objectives

J P Cairns

This paper consists of four parts. One, there is a general discussion of the way in which policies with respect to mergers, monopolies, and restrictive practices may be of significance in relation to the general objectives or goals of economic policy.[1] Two, there is a summary of the thinking on these matters contained in the recently published report by the Economic Council of Canada evaluating Canadian policy in response to a government request that such an assessment be conducted with the long-term objectives of policy in mind.[2] Three, there is a discussion of two recent Monopolies Commission reports in the United Kingdom[3] in the light of some considerations developed in parts one and two. Four, there is a discussion of the problems faced by the United Kingdom's Economic Development Committees in their attempts to promote certain co-operative arrangements within industry regarded as being in the national interest.

I

The topic assigned to this group—objectives of economic policy, the contribution of policies on monopolies, mergers and restrictive practices—raises in my mind the following questions. To what extent, if at all, should policy on monopolies, mergers and restrictive practices concern itself consciously with the various economic goals to which modern economies are rather generally committed? To illustrate, should the acceptability of a merger or a particular restrictive practice be dependent, in part at least, on its implications for, say, the balance of payments? A healthy balance of payments situation is one of the dominant objectives of policy, so that it could be argued that decisions concerning the structure of industry and permissible conduct of individual firms or groups of firms, to the extent that such decisions have balance of payments implications of more than negligible significance, should deliberately reflect the importance of this objective. Or should legislation in this area, or the administrators of such legislation, be confined to the implications for competition and market power, or perhaps to the implications for competition and market power, on the one hand, and efficiency, on the other, considerations such as the balance of payments, price stability and the like being neglected. Such a limitation on the implications to be regarded as relevant might be based on any one of several considerations. One, other instruments are available to deal with policy objectives such as the balance of payments or price stability, and it might be felt that these instruments are adequate, with no need for any support from policies dealing with competition. Two, the contribution that policy on monopolies, mergers and restrictive practices can make to objectives such as, for example, full employment, price stability, or an equitable distribution of income is minimal, and that to require the consideration of such objectives would be needlessly to confuse the issue of arriving at the best attainable structure of industry and set of competitive relationships. Three, if attention is focused on considerations of competition and efficiency, it is unlikely that the achievement of other objectives of policy will be hampered, while, conversely, if the administrators of competition policy are required to take account of a variety of economic objectives, competition policy may not do its particular job as well as it might.

It seems necessary, at the outset, to say something about the various objectives of economic policy and the way in which, if at all, policy with respect to monopolies, mergers and restrictive practices is related to each of these objectives. It may also be said that, although one thinks of these problems as having to do with the appropriate public policy response to mergers restrictive practices, etc, arising in the private sector as a result of the initiative of private firms so that the question is 'what proposed mergers are permissible?' or 'what privately arrived at restrictions on competition are tolerable?', a broader approach includes the consideration of public policies to encourage mergers by persuasion or financial assistance or to promote restraints on competition or co-operation between firms believed to be in the public interest.

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1 The objectives considered are: (1) a satisfactory rate of economic growth, (2) a high level of employment, (3) a satisfactory degree of price stability, (4) a healthy balance of payments, and (5) an equitable distribution of income.

2 Economic Council of Canada, *Interim Report on Competition Policy*, Ottawa, The Queen's Printer, July, 1969. All quotations in part 2 are from this Report.

3 *The Rank Organization Limited and The De La Rue Company Limited*, HMSO, London, 1969, and *Unilever Limited and Allied Breweries Limited*, HMSO, London, 1969. Both these reports on proposed mergers were ordered to be printed by The House of Commons, 9th June, 1969. Each report contains, as an annex, the Monopolies Commission's *General Observations on Mergers*.

The immediate impact of such policies is, to use a familiar classification, (1) on the structure of industries, and thereby the degree of market power possessed by individual firms and the competitive relationships between firms, and (2) on the conduct of firms, in the sense of which competitive—or anti-competitive—practices of individual firms and which arrangements among firms are permitted. The purpose of such policies is to influence the performance of individual firms, causing it to be more in the public interest than it would be otherwise, and this is true whether the intent of the legislation is to promote competition or to discover what restraints on competition, or agreements between enterprises, are in the public interest. An improved performance—or a performance more in the public interest—is, presumably, one that more fully assists in the achievement of the objectives of economic policy—that is, higher employment, less price instability, especially a moderation of price increases, a healthier balance of payments, a more equitable distribution of income, and a more satisfactory economic growth rate—perhaps in the sense that a positive contribution to one objective weighing more than a negative contribution to some other objective will constitute an improvement in performance. Performance, however, as a concept in the discussion of monopolies, mergers and restrictive practices, seldom relates to such ultimate economic goals as those just mentioned—rather, interest usually focuses on more limited goals—the transfer of resources from less to more efficient uses, the encouragement of cost reducing innovations, an acceptable margin between prices and costs, profit rates that are not excessive, the stimulus to improvements in quality and the introduction of new products, the reduction of wide cost and efficiency differentials between firms in particular industries, and so on—and the proposition is that policies dealing with [illegible]

It is recognized that one can interpret a greater efficiency in the use of resources as a distinct goal of economic policy and the particular province of competition policy or one can look upon competition policy as contributing to the multiplicity of policy goals modern economies accept. The practical implication of this distinction is in the design of competition policy and the directives given to the administrators of competition policy. Are the criteria to be efficiency criteria—or perhaps simply the promotion [illegible] when it is administered?

What may be said concerning mergers, monopolies and restrictive practices policy—which it will be convenient to refer to as competition policy—with respect to the ultimate goals of economic policy? It is difficult to conceive of any significant connection between the employment objective and competition policy. Policies to affect the level of aggregate demand are recognized as the key to employment policy[4] and I am not aware of any persuasive argument to the effect that the success of such policies depends on, for example, the structure of industry as influenced by competition policy. The *willingness*, however, to use aggregate demand policies to improve the level of employment may well be susceptible to the competitive consequences of competition policy, in view of the fact that the rate of price inflation associated with a given level of employment is related to the extent of market power in the economy and, therefore, to the effectiveness of competition policy in moderating the degree of market power—or the extent to which competition policy encourages market power. The Phillips curve constraint on employment policy, that is to say, is not independent of certain features of the economy that competition policy is in a position to influence. The *empirical* question is whether or not, in a particular economy, a feasible change in market power will significantly shift the Phillips curve, that is, significantly reduce the rate of inflation associated with a particular rate of employment—or is the [illegible] connection just noted is an indirect one, operating through the price stability objective. The possibility of a more direct connection may be mentioned—that a restrictive agreement, by making it possible for certain firms that would be unable to survive in a more competitive environment to continue operating, given the protection such an agreement might offer, may help maintain employment in a specific sector of the economy or particular region of the nation. It was such a consideration that resulted in the inclusion of the employment gateway in the United Kingdom's 1956 Restrictive Trade Practices Act—an interesting example of the direct impact on competition policy of what I am referring to as an ultimate economic objective. As the decision in the Yarn Spinners agreement case by the Restrictive Practices Court indicated, the obligation to consider such employment aspects places a considerable burden upon those concerned with competition policy particularly when it is necessary, as would inevitably be the case, to compare the contribution to the employment objective with the detrimental impact on resource allocation, in the sense that the beneficial impact of a restrictive agreement on employment in the industry in question is not [illegible] more efficient, firms in the industry.

The price stability objective has already been mentioned—as with the employment objective, it is to questions of aggregate demand that attention turns when price stability is considered. The link to competition policy takes the form of the already noted relationship between market power (and so competi-

[4] Supported, perhaps, by policies dealing with the location of industry and the mobility of labour, insofar as some unem[ployment] is not responsive to demand policies.

tion policy) on the one hand and the price stability—employment level opportunities available to the policy maker on the other. The way that we have put the matter suggests that the achievement of employment and price stability objectives is constrained by the pricing freedom of firms that possess market power that competition policy is unable to, or chooses not to, undermine. The approach to this problem adopted by Denmark comes to mind as worthy of mention—the monopoly legislation includes the power for the administrative authority to determine what price increases will be allowed those enterprises that possess a substantial influence over the market or to establish what price setting formulae will be acceptable. This raises, it need hardly be said, a number of issues of considerable importance—for example, whether or not the presence, on the one hand, of employment and price stability objectives, and, on the other hand, a degree of market power that makes aggregate demand policies alone an excessively costly method of stabilizing prices, calls for the addition of more specific powers with respect to prices to the policy arsenal of governments, as in Denmark.[5] The implications, in terms of determining the reasonableness and fairness of permitted price increases, may be mentioned.

Turn now to the question of the balance of payments—here we find a major attempt to relate competition policy to such considerations. One might mention the very general exclusion of export agreements from the prohibition, or control, of restrictive agreements—this may, but need not, imply a concern with the balance of payments—it may be the employment effect of exports that is of interest or, more generally, simply the proposition that restrictions that benefit domestic industry and injure foreigners are acceptable. In the United Kingdom, the so-called export gateway was placed in the 1956 Act because of a reluctance to do away with any possible source of benefit to the balance of payments, and at least one restrictive agreement—the Water Tube Boilermakers—won the approval of the Court by passing through the export gateway. It may at this point only be mentioned that, in terms of the balance of payments objective, the export gateway was peculiarly worded, so that the Economic Development Committees have found that their concern with the contribution of import substitution to the balance of payments was foundering on the 1956 Act, with the balance of payments gateway not applicable. These EDCs must be specifically mentioned as illustrative of how concern with the balance of payments—and other things—has produced a positive approach to co-operative arrangements within industry, such co-operative arrangements being in some cases restrictive agreements within the meaning of the 1956 legislation. Similarly, the Industrial Reorganisation Corporation was evidently created with balance of payments problems occupying an important part in official thinking, along with a conviction that market forces could not be relied upon to bring about, quickly enough, the structural adjustments balance of payments objectives were thought to demand. The White Paper may be quoted:

> Our future prosperity depends on our ability to bring about a fundamental improvement in the balance of payments. If we are to succeed in this, new initiatives are required to enable British industry to meet more effectively the growing competition it will face in world markets. . . . There is no evidence that we can rely on market forces alone to produce the necessary structural changes at the pace required. . . . Desirable regroupings fail to take place through lack of initiative and sponsorship, or because, when opportunities arise, there is no one ready to grasp them. The Government consider that this gap in the institutional framework needs to be filled . . . priority [is to be given] to schemes of rationalization and modernization which offer good prospects of early returns in terms of increased exports or reduced import requirements.[6]

Mention must also be made of the fact that the Monopolies Commission, in evaluating the public interest implications of mergers referred to it, has specifically addressed itself to the significance of mergers for the balance of payments. Finally, it is to be noted that the legislation of the Federal German Republic, while exempting purely export agreements from the need for approval, calls for export agreements with implications for domestic competition to be evaluated, with the evaluation evidently involving a trade-off between the export, or balance of payments contribution, on the one hand, and the interests of domestic consumers in competition, on the other hand.

It is doubtful that competition policies can be regarded as significantly relevant to the income distribution objective, even though hostility to the distributional implications of monopoly prices and profits was important in the public pressure for combines legislation in Canada and doubtless elsewhere. That it is through taxation and public expenditure policies that the distribution of income is steered in a preferred direction would be widely admitted.

There remains the question of the relevance of competition policies for economic growth. It may first be mentioned that in any listing of the factors most determinative of the rate of growth it is factors other than those directly amenable to competition policy that would most likely head the list—the use of resources for capital formation, the expansion and improved quality of educational facilities, the quality of management, the use of resources for research and development, and the constraints imposed by balance

5 The possibilities and problems of an incomes policy also come to mind at this point. *The Third General Report of the National Board of Prices and Incomes* may usefully be quoted:

'. . . The economic world with which in practice we have had to deal contains monopolistic and restrictive elements often irreversible; it is also characterized by economies of large scale production and selling, these entailing increased economic power. If this were not so, if, that is, there were uniformly free competition between worker and worker and firm and firm, it would be difficult, in the absence of an excess of total demand, for workers to impose labour cost increases on manufacturers and for the latter in turn to pass these on to the consumer. It is the very absence in the practical world of such competition in some sectors which makes necessary a prices and incomes policy; and in the execution of such a policy we have endeavoured to ensure that our recommendations would produce results more closely in accord with those which might have obtained had restrictive arrangements or unilaterally determined prices not been present. It is the change in the practical world of the nature of the competitive process which in our view dictates in part the need for a prices and incomes policy.' Cmnd. 3715, July 1968, pp. 7, 8.

6 Cmnd. 2889, *Industrial Reorganisation Corporation*, HMSO, 1966, pp. 2, 3.

of payments—price stability considerations.[7] Some of these factors—for example, expenditures on research and development—are not independent of compet…

… known arguments in favour of size which may involve market power on the grounds that it is such large firms … deve… kno… that … effic… … costs. Or it may be argued that certain sources of efficiency—and therefore a source for the freeing of resources helpful to growth—such as specialization do not emerge as a result of competitive markets and a competitive striving for success but require consultation and co-operation, and perhaps a conscious sharing of output among the firms in an industry. Hence, although growth be the main objective of policy, and although the prospects for growth are related to the competitiveness … and … com… penc… requ… com… wall… use t… … effectively, liberates productive factors for employment elsewhere—that growth …

to bring together under unified ownership and management firms regarded as too small. Growth and balance of payments considerations may, of course, be mixed with the … objecti… compet… strengtl…

II

I… … F… … only a short time ago so that I can perhaps assume it is not that well known. It so happens that the task assigned to the Council by the 1966 reference required it to take a stand on the questions which we have just been discussing, inasmuch as it was asked 'to study and advise regarding . . . combines, monopolies, mergers, and restraint of trade [and other matters] . . . in the light of the Government's long-term economic objectives'. The Council was asked, in effect, to assess the Canadian legislation and evaluate its appropriateness given (a) changes in the economic …

… Such a study involved the consideration of two questions Was the likelihood of success in achieving all (or some) of the long-term objectives … cantly rel… and restra… considerat… had hither…

[7] Harry Johnson, however, has warned of the …

[8] Williamson may be quoted With reference to the 'question of what market structures most enhance progressiveness' he finds 'the evidence . . . somewhat mixed'. He goes on to say, 'It seems unlikely, however, that subsequent … basic … some … indus… The … p. 25

[9] Edwin Mansfield's views may be noted. 'The available evidence does not seem to support [the] hypothesis [that] industries dominated by a few giant firms tend to be more progressive technologically than ones composed of a larger number of smaller firms.' He investigated the probability that 'total R and D expenditures would decrease if the largest …

trade be determined in the light of the public interest in achieving the long-term economic objectives, rather than in the light of the public interest in free competition, it being left to the administrators of the policy to bring these considerations into the picture in whatever way was seen fit, or (2) the legislation could be altered by the addition of gateways, following the 1956 British example, perhaps one for each of the five long-term objectives, and a combine, merger, monopoly or restraint of trade, otherwise condemned because of its undue effect on competition, might escape condemnation because of its contribution to one or more of these objectives.[10] In either event, the resulting legislation would have required the application of economic analysis hitherto unnecessary in enforcing the legislation, consideration of quite novel factors (growth, employment, and so on) over and above the competitive effect, and the balancing, when called for, of beneficial 'long-term objective' effects and adverse competitive effects. There would be administrative implications, of course, of such changes, as factors other than the consideration of competition became relevant, and the additional resources required to operate a system dealing with a multiplicity of criteria, rather than a single criterion, must be set against any advantages likely to be gained by increasing the range of factors to be brought into the picture by the administrators of policy.[11]

As it happened, the Council's recommendations render unnecessary the decision as to how the legislation might be revised to take account of the multiple objectives alluded to in the Government's reference. The objective of competition policy is seen to be that of obtaining the most efficient possible performance from the economy ('the promotion of dynamic efficiency, flexibility and good all-round performance in the Canadian economy', 'a single objective for competition policy: the improvement of economic efficiency and the avoidance of economic waste, with a view to enhancing the well-being of Canadians') with competitive markets seen as the most acceptable way of putting resources to work efficiently and effectively. ('It would be our conclusion that, over the greater part of the Canadian economy, and provided they are supported by adequate competition policy and other appropriate policies, competitive market forces can be an important factor making for efficient economic performance.') Competition policy should have a single objective: the improvement of economic efficiency; it should not be saddled with specific obligations to the other objectives of economic policy to which, however, it may usefully contribute. It is, of course, recognized that competition policy is not devoid of significance for the attainment of the nation's long-term economic objectives. Whether or not price stability can be combined with a high level of employment will be related to the structure of industry resulting from, among other factors, the effectiveness of policies dealing directly with mergers and monopolies; the more competitive the structure within which firms operate, the less the market power enjoyed, the less likely are prices to be increased in the absence of a growing demand.[12] The viability of the balance of payments will be related to the international competitiveness of industry, and this, in turn, will be related to the efficiency consequences of competition policy. The distribution of income will not be unaffected by whether or not competition policy promotes the ease of entry which will disturb monopoly positions and profits, and it is recognized that historically this distributional consideration has been an important factor in the development of Canadian competition policy. Other policy instruments, however, are regarded as more directly relevant, though their effectiveness may be associated with the economic environment produced by the application of competition policy. Implicit in the absence of any recommendation that, in applying competition policy account should deliberately be taken, for example, of balance of payments and/or employment considerations, is the view that the effectiveness of policies with respect to combines, mergers, monopolies and restraints of trade would be undermined if account had always to be taken of such implications as export-import effects, price stability, and so on.

The long-term objective recognized as most influenced by competition policy is that of economic growth and here the general proposition is that policies to promote competition will contribute to economic growth by encouraging productivity and the efficiency with which resources are employed.[13] Already in its first *Annual Review*, the Council had listed 'more initiative and enterprise in exploring new and better ways to use economic resources more productively, under the spur of competition and the lure of higher returns', as one of the key factors in achieving a satisfactory rate of growth. Hence, an essential thrust of the Council's recommendations is that the main types of competitive restrictions continue to be prohibited, and that any attempt to find that some such restrictions might be exempted because of offsetting benefits would be a waste of time and resources, and would simply confuse the issue. In particular, collusive

10 There are, of course, other possibilities: certain practices might be judged solely in terms of competition, others might be evaluated in terms of the 'long-term objectives' of policy.

11 This discussion minimizes the work of the Restrictive Trade Practices Commission which is authorized to make its assessment of matters referred to it in the light of the public interest. Legality, however, relates to the undueness of the effect on competition, and this legal criterion has been influential in the Commission's aproach.

12 'In so far as competition policy makes stability in the general price level easier to achieve, it mitigates the policy problem of the "trade-off" between the goals of full employment and reasonable price stability, thus making it possible to press more vigorously towards . . . full employment.'

13 'Competition policy . . . though it has at least some bearing on all five goals, is the most relevant for the goal of rapid economic growth. To the extent that the policy works as it should, it opens the way for market forces to operate more freely at all stages of the productive process and improves the prospects of rapid productivity growth.' Moreover, 'it is important to view competition and efficiency in dynamic rather than purely static terms. That is, they must be seen in a context of economic change over time, with new products, industries and methods of distribution constantly coming forward and old ones dying off.' And, in this connection, 'the dynamic view [of efficiency] . . . implies . . . that monopoly and restrictive practices should not be allowed to get in the way of this process [resources moving freely into new and better patterns of use]'.

arrangements to fix prices, to allocate markets, to prevent the entry of new firms or expansion of existing firms, should be criminal offences, as should resale price maintenance and misleading advertising. The [illegible]

Certain major exceptions to this per se philosophy must be noted. Mergers, at present, are illegal if they lessen competition to the detriment of the public. The Crown is required to demonstrate such lessening in order to secure a conviction, a task that has, in fact, been of unsurmountable difficulty. It is proposed that, in the case of mergers, what may be called an efficiency defence should be permitted, i.e., in the assessment of mergers the implications for competition should be considered in the light of any demonstration of predicted efficiency gains the proponents of the merger are able to offer.[14] The Council has recommended, however, and this seems to be in contrast to recent United Kingdom experience, that the only factors meriting consideration to offset the consequences for competition are improvements in the efficiency with which resources are employed.[15] It must be mentioned that this suggestion that the efficiency implications of a merger be taken into account, as a possible offset to market power implications, would represent a major change in Canadian mergers policy, if implemented. Efficiency has, of course, always been a major concern of Canadian competition policy; it has been assumed that the promotion of competition would promote efficiency; what is novel in the Council's merger policy proposal is the suggestion that efficiency gains might justify a merger otherwise condemned because of its implications for market power.[16]

The Council has also proposed that, although the emphasis on restraints of competition continue to be that they be prohibited outright, an exception be made in the case of specialization agreements, the promoters of which will be allowed to seek authorization to operate the agreement from the to-be-established Competitive Practices Tribunal, with authorization to be granted only if the Tribunal was satisfied that the specialization agreement would permit longer production runs and lower costs, and that Canadian consumers would benefit thereby.[17] Theoretically, this proposal which is, of course, in the European tradition, is perhaps even more of an [illegible]

It appears, therefore, that not only does the present Canadian legislation avoid the difficulties associated with multiple goals by its emphasis on competition, the Council's recommendations pretty well also avoid these difficulties by insisting that competition policy should concern itself with efficiency in the use of resources, that other policy considerations need not enter the picture, and that, with the exception of mergers and specialization agreements (and certain business practices), a straightforward prohibitory approach is appropriate.[18]

III

One or two observations on recent mergers policy in the United Kingdom may be made in the light of the above comments on the position taken by the Economic Council of Canada, in particular, its view that efficiency improvements be the only acceptable offset to the competitive detriment a merger may produce.

In its recently published *General Observations on Mergers*, the Monopolies Commission states that 'the overall effects of such horizontal and vertical mergers may be assessed with reference to their effects on competition on the one hand and on efficiency on the other'.[19] The Commission may, however, bring into

[14] This suggestion of an efficiency defence as an offset to an adverse competitive effect is one way in which considerations of efficiency can enter mergers policy. Another way is through the proposition that the illegality of mergers in some cases be based on the fact that the merger, by promoting efficiency, will have an adverse impact on the viability of other, smaller, firms in the industry, and hence harm the competitive structure of the industry. The efficiency defence approach indicates a willingness to accept otherwise undesirable competitive effects if there are gains in efficiency to be achieved, the other approach indicates a willingness to maintain competition and relatively unconcentrated industries even at the cost of reduced efficiency

[15] The language used is as follows: 'The likelihood that the merger would be productive of substantial "social savings", i.e., savings in the use of resources (including resources used for such purposes as research and development), viewed from the standpoint of the Canadian economy as a whole.'

[16] Important, also, is the recommendation that mergers should not be treated within the criminal law, but are to be assessed by a tribunal guided by a declaration that 'competitive market forces provide an important means whereby the total productive resources available to the Canadian economy may be employed as efficiently as possible to maximize real income and the economic welfare of Canadian consumers'.

[17] 'Reference was made to the opportunities available to Canadian industry for cost reductions based on longer production runs, and to the fact that market forces cannot always be relied upon to bring about the exploitation of these opportunities. It seems to us that firms considering themselves to be in this position should be given a chance to satisfy the proposed tribunal that they could, by means of specialization agreements, achieve longer production runs and lower unit costs. The tribunal would also have to be satisfied that a substantial part of any cost savings realized was likely to be passed on to Canadian consumers of the affected products.'

[18] The Tribunal, it is recommended, should also have referred to it certain trade practices for a public interest assessment focusing [illegible] presumption that they are normally detrimental to the public. It must be stressed that the really significant feature of the Council's recommendations is not that the per se prohibitory approach be strengthened in certain areas, but that a more flexible approach, involving economic analysis of efficiency and competitive implications, be employed in the case of mergers, specialization agreements, and trade practices, involving a sharp break with the criminal law nature of the present legislation.

[19] 'In horizontal and vertical mergers the gains likely to flow from increases in efficiency may be found great enough to offset some losses resulting from an impairment of competition and the merger may accordingly be regarded as compatible with the public interest' (Para. 21)

the picture whatever aspects of economic policy it considers appropriate. Thus, in considering conglomerate mergers, as it has recently been required to do, the Commission, while asking competition and efficiency questions as in the horizontal or vertical case, is likely, given the greater uncertainty concerning such matters in a conglomerate merger, to address itself to other considerations. In its two recent reports on conglomerate mergers, for example, the Commission concerned itself with the possible balance of payments implications,[20] stating in the Unilever-Allied Breweries Report, to illustrate, its recognition of 'the public interest in present circumstances of securing a substantial improvement in the United Kingdom balance of payments through exports and in other ways'.[21] The Commission's approval of the proposed Unilever-Allied merger was not, it must be noted, based on any view that the merger would produce significant balance of payments benefits, which were found to be 'uncertain and small'; what is important is this: had the Commission found substantial balance of payments detriments, it is likely that the merger would have been rejected, as the Commission failed to uncover any benefits of significance. And in its recommendation that the Rank-De La Rue merger not be permitted, the Commission was strongly influenced by its view that there was 'a serious risk that the efficiency and trading volume of De La Rue will be adversely affected'. 'If De La Rue were relatively unimportant in its various fields of operation, the recognition of this serious risk would not necessarily involve the public interest.' But, given the fact that De La Rue faced 'overseas competititors' in fields in which it was 'one of the leading companies', this expected 'loss of efficiency would correspondingly harm the public interest including the balance of payments'.[22]

In concerning itself with balance of payments considerations, the Commission is, of course, simply recognizing the importance of this matter in British economic policy to the extent, at least, of accepting a trade-off relationship between an improvement in the balance of payments and other policy objectives, even, conceivably, admitting that a weakening of the balance of payments becomes, at some point and under certain conditions, a constraint that will override other considerations. Be that as it may, the balance of payments implications may be short run, so that a change in the structure of an industry, a matter with long run consequences, may be judged largely from a short-run point of view. In Rank-De La Rue, the Commission was careful to note the 'damaging long-term implications'[23] of the predicted loss of efficiency; it seems fair to say, however, that the consequences of the merger that most alarmed the Commission were its immediate effects on the morale and continued availability of key management personnel in De La Rue. This immediate effect, though stated to have long-term implications, carried more weight than did the possibility that Rank's greater 'marketing orientation' might lead to greater efficiency in a more remote future. If the possibility of mergers with short-run balance of payments implications pointing in an adverse public interest direction, and longer-run productivity implications pointing in the other direction, is admitted, then there is an obvious risk that short-term implications may militate against beneficial, or in favour of detrimental, structural changes. It may also be pointed out that whether or not a given balance of payments effect is decisive will depend on the seriousness of the balance of payments position at the time the public interest assessment is made; the Commission, in its Unilever-Allied Report referred to the public interest 'in present circumstances' of improving the balance of payments. This suggests that, for example, otherwise equivalent mergers may be condemned or approved, depending on the prevailing balance of payments situation. To the extent that this is so, the rather curious consequence

[20] The possible implications of a merger for exports, and therefore the balance of payments, has been considered in at least two other Commission merger reports. In the *Guest, Keen and Nettlefolds Ltd and Birfield Ltd* report the Commission stated 'we have little doubt that it would be to the national advantage' if GKN 'increased its exports and other overseas trade' and used 'Birfield's established footholds in Europe for selling on a much larger scale the products of the merged company' (para. 154). And in *British Insulated Callender's Cables Ltd and Pyrotenax Ltd*, the Commission stated that 'It may turn out that the most valuable result of the merger for the public interest will be that it will make possible a more rapid increase in exports . . . Since the resources available prevent an adequate effort being made by the two companies separately in all the [overseas] markets that appear ripe for development, it seems to make better sense for them to combine and co-ordinate their resources, rather than to continue to compete with each other in the same markets, as had been happening before the merger . . . BICC has ample resources and plenty of experience of overseas markets generally, but Pyrotenax can contribute greater experience of the special problems of selling mineral insulated cable. We consider that the combination of the two should have a better chance of achieving successful results quickly than they would have had as separate companies . . . the reduced production costs resulting from the merger should also increase their competitive strength abroad' (para. 160).

[21] Para. 121.

[22] Para. 103.

Another striking feature of the Commission's verdict that the Rank-De La Rue merger was not in the public interest and should not be permitted was the fact that the Commission found no adverse consequences for competition in the merger. 'We feel justified in disregarding the [zero to negligible] anti-competitive effects' (para. 87). Hence, it was not a question of reaching a judgment on the more usual United Kingdom basis of comparing a detrimental impact on competition, on the one hand, with claimed benefits for efficiency on the other hand. Instead, the Commission was of the opinion that efficiency would suffer were the merger allowed, because of the consequences for the De La Rue management and that this would be harmful from the point of view of the public interest in exports and a healthy balance of payments. Had competitive effects alone been considered as, for example, in the United States and Canada, the merger would have been cleared as harmless. It seems to me that there is a qualitative difference between prohibiting a merger because it may lessen competition, as in the United States, regardless of any contribution to efficiency, such a contribution being treated as a quite irrelevant consideration, and prohibiting a merger because it may (the Commission speaks of 'near-certainty') be harmful to efficiency and the balance of payments, while neutral with respec to competition.

In its *General Observations on Mergers* the Commission clearly stated that 'in conglomerate mergers, losses in efficiency may in some cases be found sufficiently likely and substantial even in the absence of anticompetition consequences, to cause the merger to be regarded as contrary to the public interest' (para. 21). Presumably, horizontal and vertical mergers with no anti-competition effects, may also be found against the public interest on efficiency lowering grounds.

[23] Para. 104.

emerges that the determination of the appropriate [illegible] subject to the requirements of short-run problems.[24]

It may again be noted that concern with the balance of payments, which the Monopolies Commission has [illegible]

The so-called 'export gateway', whereby a restrictive agreement might escape the general condemnation of the Act if otherwise there would be a substantial 'reduction in the volume or earnings of the export business', was undoubtedly included in the legislation with balance of payments considerations in mind; that the gateway was badly worded to bring such considerations satisfactorily into the picture has been pointed out by more than one critic of the Act. The narrow focus on exports of this 'balance of payments' gateway is to be seen as a factor frustrating attempts, for example, to encourage import-substitution agreements and, hence, leading to the recent amendment authorizing the exemption of agreements regarded by the Board of Trade as of national importance.

The United Kingdom's 1956 Act can, in fact, from the view-point of this discussion be seen as an attempt to ensure that macro-policy objectives would be brought into the picture when restrictive agreements were being evaluated. The endeavour, via the 'export gateway' to introduce balance of payments considerations has already been noted. Equally striking is the employment gateway, whereby a restriction may be found not contrary to the public interest if its removal 'would be likely to have a serious and persistent adverse effect on the general level of unemployment', Ignoring the questions of the merits of an employment gateway for a restrictive agreement and the particular way in which this gateway was worded, attention may be profitably drawn to the criticism of this gateway most relevant for this discussion: the difficulty of an intelligent application of this gateway in the absence of a knowledge of governmental policy given whatever unemployment effects in fact developed. The discussion is perhaps academic now, but clearly restrictive agreements might well have been approved because they helped to maintain employment when, given the termination of the agreement, other governmental policy could have served the employment goal without incurring the cost of the restriction. The lack of co-operation between competition policy administrators making employment effect judgments, on the one hand, and employment policy administrators, on the other, is revealed as a potential barrier to the consistency of policy.[25]

The variety of policy considerations included in the 1956 Act's gateways may be contrasted with the [illegible] tives, as well as others. Attempts were made to have the Resale Prices Act gateways reflect a similar [illegible] than those that concerned consumers were best left [illegible] of resale price maintenance was to be based on a single criterion, the economic welfare of consumers, and was not to include the variety of criteria in terms of which the overall achievements of economic policy are judged

IV

It is evident that problems arise in the administration of competition policy when doubts exist as to the sufficiency for such economic objectives as, for example, economic growth and a viable balance of payments, of policies designed primarily to weaken the grip on the economy of restraints on competition Concern with these matters has produced new institutions in the United Kingdom which have resulted in difficulties in reconciling the work of these bodies with other institutions and legislation concerned with restraints on competition.

E. F. Denison, in his chapter in the Brookings study of *Britain's Economic Prospects* refers to two possible approaches to achieving greater efficiency and a more satisfactory rate of growth in the United Kingdom.[26] 'One is to greatly intensify competition among [illegible] survive, they will be replaced by more efficient firms' (It may be noted that Denison does not think that the United Kingdom has gone far enough in promoting competition to discover whether or not the competitive approach might succeed. He writes: 'Greatly strengthened competition would require a major change in the domestic legal structure, rather than the halting steps already taken against restrictive practices') The Restrictive Trade Practices Act of 1956 and the Resale Prices Act of 1964 may be seen as steps in this direction, steps which, in large part because of the scepticism of the Restrictive Practices Court to arguments in favour of restrictions, have gone some way towards eliminating those restraints on competition which minimize pressures on individual firms to increase

[24] For a valuable discussion of the issues involved in assessing the public interest implications of mergers, see Oliver E Williamson, 'Economies as an Antitrust Defense', *American Economic Review*, March, 1968. Williamson 'calls attention to the importance of considering the shape of the time stream of benefits and costs that a merger produces'.

[25] This is discussed by B S Yamey in *The United Kingdom Approach to Restrictive Business Agreements: Some Observations*, British Institute of International and Comparative Law, London, reprint.

[26] E F Denison, 'Economic Growth' in *Britain's Economic Prospects*, R E Caves and Associates, The Brookings Institution, Washington 1968, pp. 277, 278.

efficiency.[27] It is clear, however, that the British government is not prepared to rely on the increasingly competitive environment generated by this legislation to bring about the efficiency improvements growth and balance of payment objectives point to.[28] Hence, the growing use of the second approach noted by Denison: 'use of persuasion by the government or government-sponsored organizations', a 'popular means of raising efficiency but thus far [the book appeared in 1968] persuasion seems not to have been very effective'. The institutions that come to mind here are the Industrial Reorganisation Corporation, concerned with promoting those structural reorganizations thought to be in the national interest and unlikely to come about without some persuasion or more direct help, and the Economic Development Committees, or little Neddies, created to consider ways of improving an industry's economic performance, competitive powers and efficiency and to make recommendations on these matters as appropriate.[29] These institutions, based as they are on a particular approach to economic objectives, have produced a number of problems, given the existence of other institutions reflecting a different approach.

Looking only at the EDCs, the conflict between EDC recommendations and the 1956 Restrictive Trade Practices Act was not resolved until the 1968 amendment which authorized the Board of Trade to excuse efficiency-promoting agreements of national importance from the public interest scrutiny of the Restrictive Practices Court. The need for such an amendment, with the clear suggestion that agreements in the national interest, as seen by an EDC, would be found contrary to the public interest, were they assessed in the light of the criteria, or gateways, of the 1956 Act, can hardly fail to create doubts as to the official acceptance of the continued validity of the 1956 approach, including its procedures. The main deficiency of the 1956 Act might simply be the inadequacy of its balance of payments, or export, gateway. It appears that the EDCs have concerned themselves to a considerable extent with the export-import balance of their industries,[30] with particular interest in the possibility of closer contact between supplier and customer EDCs leading to the substitution of domestic for imported supplies; such agreements might well have survived an examination by the Restrictive Practices Court had the 1956 Act's export gateway been more appropriately worded. The inadequacy, if not irrelevance, of the export gateway for the balance of payments objective was pointed out shortly after the 1956 Act was passed, most notably, to my knowledge, by Professor Yamey—had the legislation been revised in the light of his comments, the EDC—Restrictive Trade Practices Act dilemma might not have appeared, at least with respect to arrangements designed to replace imports with domestic supplies. Professor Yamey wrote, in 1962, and perhaps he expressed similar ideas earlier, that 'the working of the exports paragraph does not mention the balance of payments at all, and focuses on other economic variables in a way which is not consistent with any rational objective of foreign economic policy. . . . It is surely not beyond the capabilities of parliamentary draftsmen and those who advise them to reword the exports paragraph . . . to bring it more closely into line with the policy objective it seems designed to serve'.[31]

More important, however, than the question of the wording of a particular gateway, is the economic philosophy implicit in the existence of the EDCs. (It may be noted that Professor Yamey pointed out, a number of years ago,[32] that something like the EDCs are, in fact, logically inherent in the 1956 legislation, which, by recognizing the possibility of restrictive agreements that are in the public interest, implies that it is not sufficient to count on private firms independently to produce such agreements—it is in the

27 The Court has, in its judgments, demonstrated concern for the way in which restraints on competition permit high cost firms to continue in operation. Decisions of other European institutions applying competition policy, as, for example, Sweden's Freedom of Commerce Board, have reflected a similar concern.

28 It would, incidentally, be helpful to have more information concerning developments in those British industries that have had to abandon restrictive agreements—have the less efficient firms, in fact, been eliminated? has there been a narrowing of cost and efficiency differentials within the industry? has there been an upsurge in innovations and a growing interest in reducing costs? and so on, recognizing that it would not be easy to assess the part played by the abandonment of a restrictive agreement in such developments—and, if the sort of beneficial change predicted by theories of competition is not observed, why not? Has some new form of restriction made an appearance? See P Lesley Cook, 'Effects of The Restrictive Trade Practices Act: Analysis of the Effects of Ending Price Agreements', *Oxford Economic Papers*, November, 1965. The important point is made that, in at least two instances, cement and wire rope, it would have been easy to err in finding a causal relationship between structural developments and the 1956 Act.

29 Director-General Catherwood may be quoted: 'The EDCs will work best where the market economy alone does not give the results required for rapid and sustained economic growth or does not give them fast enough.' The widespread dismantling of restrictive agreements in consequence of the 1956 Act is clearly rejected as a reliable source of increased productivity: consultation, co-operation, and the sharing of ideas is the preferred avenue to greater efficiency. The steady increase in the number of EDCs so that a large portion of the private economy is covered indicates that it is this co-operative rather than the competitive solution which most finds official favour. *Britain With the Brakes Off*, Hodder and Stoughton, 1966, Chapter 10, 'Micro-economics—The Little Neddies'.

30 H F R Catherwood wrote in 'The Planning Dialogue', *National Westminster Bank Quarterly Review*, May, 1969, p. 7, that 'we have to shift resources into the right investments and the right exports. All twenty-one of the little Neddies are working at the moment to identify where this shift of resources can be achieved, what are the right investments and which are profitable exports. . . . Our immediate problem continues to be the balance of payments; and it is for this reason that some EDCs have been picked to carry out detailed studies because of their import and export propensities'.

31 B S Yamey, 'Some Issues in our Monopolies Legislation', *The Three Banks Reivew*, June, 1962, pp. 17–18.

32 See his BIICL article already cited. 'Does it not follow that the introduction and enforcement of restrictive agreements is too serious a matter to be left to business firms? Should the government not establish machinery for investigation of industries in which appropriate restrictive agreements would promote export earnings or confer specific and substantial benefits on consumers, and for the introduction and enforcement of these agreements? . . . is it not the responsibility of government to see not only that beneficial restrictions are not abolished but also that desirable restrictions are introduced.' Yamey makes it clear that he is not 'advocating the setting up of machinery for the official promotion of virtuous restrictive agreements', he is only trying 'to make explicit what seems to me to be implicit in our [1956] approach', pp. 26–7.

public interest that such beneficial agreements, if they exist, should be actively sought and, when found, enforced. The ability of the members of the Standard Metal Window Association [illegible]

[illegible]

firm independently to seek such business; there is, however, an unwillingness to wait for such initiative. The assumption is, instead, that these opportunities will be seized only following EDC consultations, presumably involving some assurance from the customer EDC to purchase domestically previously imported supplies. If, to repeat, such import substitutes can be competitively produced at home, one wonders why a decision to do so required the elaborate procedure of EDC consultation; if, on the other hand, domestic production is not competitive, the encouragement of such production may be in the national interest on balance of payments grounds, but hardly otherwise. It resembles, in fact, the imposition of a tariff barrier if it results in the replacement of imports with higher cost domestic production.

The difficulty experienced in the United Kingdom in promoting co-operation between firms may be contrasted with the experience of the Federal German Republic where, as I understand the matter, a feeling that the Law Against Restraints of Competition was unduly hampering the growth of certain types of [illegible]

[illegible]

gateways and its interpretation thereof and the condemnation of agreements to the like effect as those already condemned or abandoned, with a resultant fear that discussions of co-operation possibilities might involve contempt of court. As a result, agreements favoured by the EDCs could not be entered into, until the Act was formally amended. In Germany, a much more informal procedure seems to have been available, involving, in the first instance, statements by government officials concerning which agreements would not run afoul of the Act ('a compilation on inter-enterprise co-operation . . . to advise small and medium-sized enterprises of possibilities for co-operation which are in conformity with the law') and announcements by the Cartel Office concerning the way in which [illegible]

[illegible]

a prima facie presumption that specialization cartels promote efficiency and that, except where market domination is created or strengthened, the resulting rationalization is appropriately related to the restrictions involved'.[33] The Act was eventually amended but the point remains that it was possible to adopt a more flexible approach to specialization agreements [illegible]

[illegible] approach imposed.

[33] C D Edwards, *Trade Regulations Overseas—The National Laws*, Oceana Publications, 1966, p. 184.

1.3 An excess of pragmatism

S Brittan

1 Objectives

The title of this working group, 'The Objectives of Economic Policy' is a temptation first to jot down the familiar list: growth, price stability, full employment and balance of payments equilibrium and then guess how much monopoly policy contributes to each, and how it could be altered to contribute more. But to do so would be wrong. Monopoly policy has a very important effect on two other objectives: the development of a free society and the rule of law. Nor can these other aspects be banished to some imaginary conference of political philosophers taking place somewhere else. The effects of policy on freedom and the rule of law are sometimes only evident after a careful economic analysis; and if the economic student neglects them, he cannot rely on anyone else to take them up in his place.

One vital aspect of a free society is freedom of choice. The concept embraces Sir Isaiah Berlin's 'negative freedom'—the absence of coercion.[1] But it extends a little wider. If a laundry closes down in a small town, leaving me a smaller range of choice as either a consumer or a laundry worker, it would be stretching the meaning of words to say that I am coerced; but my freedom of choice has certainly been narrowed.

In the laundry case an ideal index of my real income would show a reduction, even though my earnings and the general price level are unchanged. But the possibility of this kind of phenomenon being taken into account in any foreseeable national income calculation is so remote, that for policy purposes we should regard freedom of choice as an objective in its own right rather than as an aspect of any narrowly economic goal. If we do this, we are also able to consider other aspects of a free society, such as the concentration of power in the hands of individuals and groups, which could hardly be brought into even a theoretical real income calculation without distortion.

The concept of 'The rule of law' that I am using here has been outlined by Hayek in the following words: 'It is because the law-giver does not know the particular cases to which his rules will apply, and it is because the judge who applies them has no choice in drawing the conclusions that follow from the existing body of rules and particular facts of the case, that it can be said that laws and not men rule.'[2] Conformity with abstract and impersonal law should not be the only criterion of policy; but it should be one and given some weight in our discussion.

2 The slaughter of restrictive practices

There are two main classes of problem in 'monopoly' policy: restrictive arrangements between otherwise independent firms; and the size of economic units.

The British economy has moved in radically different directions in these two areas. It has become much more competitive, in the sense that there are fewer price rings and cartel-like agreements, but it has also become more monopolistic, in the sense that a handful of firms—sometimes only one—hold a dominant position in far more industries today than a few years ago.

In his chapter in the *Brookings Report on the UK*,[3] Professor Caves speaks of 'revolutionary changes' in British attitudes to restrictive practices. Before the Second World War some 30 per cent of factory employment was estimated to have been in trades covered by price rings and other restrictive practices. In his 1967 Report, the Registrar of Restrictive Practices was able to declare that 'the mass of price fixing agreements has been dismantled and there is no backlog of important agreements awaiting their turn to be referred to the court'. The use of information agreements as a possible loophole has been made more difficult by the 1968 Act, giving the Board of Trade power to call for their registration. This was in great contrast to the position less than ten years before when over 2,000 agreements to fix prices, restrict entry or share markets, were registered under the 1956 Act.

Resale price maintenance was a later victim, but it has been crumbling since the 1964 Act. A few years before it was believed to cover about a third of consumer goods sold to British householders. The Monopolies Commission has condemned the fixed scale of fees to estate agents, and other professional practices are still being investigated by the Commission. The one area so far untouched is the City where the clearing banks, for example, have actually been encouraged

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1 *Two Concepts of Liberty*, Oxford, 1958.

2 *The Constitution of Liberty*, Routledge and Kegan Paul, 1960, p. 153.

3 Allen & Unwin, 1969.

by the authorities to retain a fixed scale of interest payments because of the supposed needs of monetary policy. Even this last bastion may, however, crumble slowly as a result of the competition of overseas banks and the gulf that has developed between Bank Rate and market interest rates.

Action against restrictive practices scores high marks for all objectives of policy. It releases resources previously tied down in inefficient operations; it gives the consumer a choice between different combinations of price and service, breaks down barriers to entry, and makes it easier for distributors to offer a wider range of products. This branch of policy also scores highly from a 'rule of law' point of view. Certain classes of agreements are treated as prima facie against the public interest, and exceptions must be justified along established gateways to the Restrictive Practices Court rather than to a Government department. Of course, the Court does in practice have to make an economic judgment, sometimes of a peculiar kind. But the area of predictability is much greater than in the case of monopolies or mergers, and the scope for free-ranging Ministerial judgment, or [illegible]

tices such as collective boycotts, exclusive dealing and aggregated rebates against the public interest.

Recent legislation would undoubtedly have been much less effective in a different industrial climate. The majority of registered restrictive practices and resale price maintenance agreements were abandoned without a fight. Had each agreement been defended in court the backlog of cases would have lasted many years (and until the 1968 amending Act the Registrar lacked effective sanctions to secure registration). Continued full employment and good order books undoubtedly made firms more willing to abandon defensive arrangements born of the Depression years. It was just because the business climate was less 'competitive' in one sense of that much abused term that it could become more competitive in another.

3 The effects of competition

How effective the slaughter of restrictive practices has been in promoting productivity or holding back prices is not easy to ascertain. There is some circumstantial evidence on the prices front. For year after year in the second half of the 1960s, the rise in prices in relation to wages has been less than had been expected by official and unofficial economic forecasters. Indeed it was because prices at factor cost rose so little that the Treasury had to step in so frequently to 'mop up' purchasing power by raising indirect taxes.

This lag in prices below forecasts reflects both a falling secular share of profits in the national income at least before tax and allowances and some spurt in productivity. The NED Office estimates that pre-tax trading profits net of capital consumption rose by an average of 1·9 per cent p.a. between 1960 and 1967. During this period weekly wage earnings rose by over [illegible] cent.

Despite all the international league tables, British productivity has been accelerating for over a decade. Allowing as best one can for cyclical influences and other disturbances, real GNP per person employed was rising at about 1½ per cent p.a. in the early 1950s, just over 2 per cent in 1955–62, and by 1966 had probably accelerated to about 3 per cent. The underlying movement since then is particularly difficult to determine, but it has probably risen to about 3–3½ per cent. By historical British standards this is a remarkable performance.

[illegible] rather small, perhaps 7 per cent for most industrial countries. After they had taken place, the effective level of protection in Britain was increased by the import surcharge of 1964–6, which was followed by the [illegible] causes of increased productivity were not operative in the 1960s.

The secular decline in the rate of return on capital, and the share of pre-tax profits in the national income, was probably due to a number of factors: overall demand management, the differential effect of prices and incomes policy on prices; overseas competition (despite the protective barriers) and perhaps a decline in the marginal productivity of capital due to an excess of 'widening investment' relative to the [illegible] future. The way to deal with it is not to back-pedal on restrictive practices, or allow excess demand to be created, but to alter those other elements of economic policy which artificially depress the share of profits.

4 The growth of concentration

A large share of credit for the improvement in productivity should also go to the takeover bids of the [illegible]

1.3 An excess of pragmatism

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Act of 1948, the Monopolies Commission was required to examine each agreement referred to it, on a case-by-case basis with no prior presumptions of any kind But the same kind of case and the same kind of argument occurred so frequently that the desirability for a more general approach became obvious. The seal was set by a Report of the Commission on Collective [illegible]

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Clearly many factors must have been at work. [illegible] level of protection in Britain was increased by the import surcharge of 1964–6, which was followed by the 1967 devaluation—and the imposition of Prior Deposits in 1968 These have dwarfed the first instalment of the Kennedy Round Tariffs Act introduced in July, 1968. Manufacturing investment has actually been falling as a proportion of GNP in the 1960s, if one compares cyclical peaks Thus some of the normal causes of increased productivity were not operative in the 1960s.

The secular decline in the rate of return on capital, and the share of pre-tax profits in the national income, was probably due to a number of factors: overall demand management, the differential effect of prices and incomes policy on prices; overseas competition (despite the protective barriers) and perhaps a [illegible] would expect a search for lower-cost, labour-saving methods in such a situation; but the low level of aggregate investment could pose a threat for the future. The way to deal with it is not to back-pedal on restrictive practices, or allow excess demand to be created, but to alter those other elements of economic policy which artificially depress the share of profits.

4 The growth of concentration

A large share of credit for the improvement in productivity should also go to the takeover bids of the period This thought might make a good transition to the more topical half of monopoly policy: mergers and size. Yet one must be careful. For a takeover bid need not lead to a merger to have a healthy economic effect. On the contrary the healthiest kind of takeover

bid is probably one that is successfully shaken off at the cost of an internal revolution in the courted firm. One might argue that the healthiest event in postwar British company history was ICI's unsuccessful bid for Courtaulds in the early 1960s, which failed, but led to a change towards a much more profit-conscious management on the part of Courtaulds. The battle was severely condemned as a bad advertisement for capitalism by leader-writers and MPs of different political persuasions; and this should have given a clue that something desirable was taking place. A comprehensive study of firms which have successfully escaped the takeover bidders would make a useful piece of research.

Unfortunately, however, this has not been the typical situation; and in the majority of practical cases there is no escaping the vexed question of how one assesses the gains which are claimed for larger units and weighs them against the possible costs.

There has been a rapid increase in the degree of concentration since the end of the war. Research into the share of the fifty largest units in total gross profits in manufacturing and distribution suggests, according to Professor Caves, a rise from 1908 until 1938, a fall between 1938 and 1950 and a rapid rise in the 1950s. The trend of the 1950s is shown even more clearly by another measure: industries in which the three largest firms controlled more than 50 per cent of net output. These accounted for 12·7 per cent of British manufacturing in 1951 and 21·7 per cent in 1958.

The movement accelerated in the 1960s. This is demonstrated by a Monopolies Commission survey of quoted manufacturing companies with net assets of more than £0·5m at the beginning of 1961. The twenty-eight largest companies in this survey held 39 per cent of total net assets in 1961, but by 1968 their share had risen to 50 per cent. The total population of companies, defined in the above way, fell from 1,312 in 1961 to 908 in 1968.

Clearly not all the increase in the degree of concentration has been due to takeovers and mergers. Existing large companies have increased their share of the market and some smaller concerns have gone out of business. But the merger movement has been the biggest as well as most dramatic influence in recent years. The book value of the net assets acquired by quoted companies in the eight years covered by the Monopolies Commission survey was £2,750m, no less than one-fifth of the total. Figures for individual recent years are even more startling. Net assets transferred by mergers were 1½ per cent of the total in 1966, 3¾ per cent in 1967 and 6½ per cent of the total in 1968.

It would be absurd to project this series into the future, as it would show the whole of manufacturing industry under one big firm before very long. Even so, recent trends show an increase in the degree of concentration which would have been found highly alarming by the Founding Fathers of the US Anti-Trust Acts.

A further reason for concentrating attention on mergers is that it is much easier to prevent the birth of an industrial giant than to break it up once it has been formed. The simple presumption against higher concentration found in US law will not do in the UK, or in most other European countries, for well-known reasons. In economies which are so much smaller than the American, a high degree of concentration will arise as with firms of much smaller absolute size. In addition output per head on this side of the Atlantic has not yet reached a level where economic losses can be completely disregarded in any comparison with the wider social benefits of competition and diversity. There is no escape from some form of cost benefit approach.

5 Criteria for mergers

Once it is accepted that some mergers are on balance desirable and others not, it is no longer surprising that there should be in the UK two official pieces of machinery, the Monopolies Commission, at the time of writing destined to become the Commission for Industry and Manpower, and the Industrial Reorganisation Corporation. The latter has tasks of promoting mergers and the former that of vetting them with a view to possible prevention. One body is there to search for situations where the gains exceed the losses; the other to identify areas where the losses are likely to predominate. Nor is a degree of rivalry between the two necessarily a bad thing. The balancing of risks is necessarily subjective and controversial; and competition among official agencies can sometimes provide better performance—provided that the co-ordinating machinery is good enough to prevent an IRC-promoted merger being sent for investigation to the Commission. Interesting though such a spectacle might be, the costs in management frustration make such experiments undesirable!

On the whole the co-ordinating machinery does seem to work quite well, though there have been one or two close shaves. IRC was, for example, involved in the negotiation between Associated Fisheries and the Ross Group for a jointly owned trawling company. The Corporation dryly remarks in its 1968–9 Report that 'since 1966, when the Monopolies Commission recommended against the total merger of the trawling and distribution businesses of the two concerns the difficulties of the trawling end have increased'. Provided that this sort of situation can be avoided, competition between the two bodies is healthy. There is a contrast here with macro-economic policy where rivalry between two Ministries does nothing but harm. For while demand management is indivisible, the DEP (which shortly after the Conference took over from the Board of Trade monopoly policy) and the Ministry of Technology (which is now responsible for IRC) can agree to divide their attentions among different industries and firms.

The economic analysis of mergers has been outlined in a recent paper by Professor Beesley in terms of the trade-off between the cost-reducing and price-increasing effects.[4] If the reduction in costs per unit exceeds the increase in profit margins arising from increased market power, then the merger should be allowed, *provided that there are no alternative ways of gaining*

4 *Economic Effects of National Politics Towards Mergers and Acquisitions*, Paper given at a London Conference on Long Range Planning, 18 February 1969, available from London Business School.

the benefits. If the price per unit is likely to rise, there will be still a gain in potential national income but

dangers of too narrow a preoccupation with individual industries and firms. If one takes into account the range of choices available to citizens in a wider sense, the degree of concentration in the whole

companies have a great deal of influence of a less tangible kind. They exercise considerable powers of patronage; they can set fashions in subjects ranging from architecture to economic policy. They can make certain political views respectable among influential opinion, as well as finance their propagation. The list of such activities is open-ended; and provided the firms which exercise such influence are sufficiently numerous and diverse in outlook, society is likely to be freer as a result of this rivalry. Professor Milton Friedman has a perfectly legitimate point when he describes how some of the victims of the McCarthyite

greatest danger is in fact the utopia of the 'indicative planner' when all the industrialists who matter can meet in one room, together with Ministers and officials, and arrive at a common view. Whether this is seen as

such as Sweden or Switzerland have to pay for political and economic independence. But for countries like the UK, where the public school cum trade-union tradition of the 'done thing' is already great enough, it would be a total disaster. There is still sufficient diversity in the British economy for the threat to be a distant one; but it is a reason for not allowing the reduction in the number of decision-making units revealed in the Monopolies Commission Report to go on indefinitely.

The ideal criteria for judging the potential anti-competitive effects on large units cannot be set out in any simple way. The old formulae of market shares, or the elasticity of demand facing the merged concerns, have well known deficiencies. Freedom of entry is often more relevant than static market shares. The existence of a certain number of conglomerates on the look-out for fields with above average rates of return can actually promote new entry in monopolized industries. The threat to freedom arises if there are too few very big conglomerates taking up too large a

balance to be struck is an extremely delicate one.

If we are interested in freedom of choice, a takeover by an overseas concern may often be preferable to a

of choice to both customer and potential employer. On the narrower economic front, numerous studies have shown the return on capital output per head and level of exports of US subsidiaries to be on average higher than those of native British companies.

It would be foolish to deny that there can be problems of conflict of jurisdiction. The governments of both the host country and of the parent may have rival claims over subsidiaries. It would also be desirable to have more international European companies, which would add an element of variety to the business scene, and would put a brake on the spread of a uniform American-type culture throughout the Continent. The obstacles presented by diverse European laws can be tackled, if need be, quite independently of the EEC. In the meanwhile the same wider social considerations, which should cause one to welcome a substantial overseas stake in local industry should make one reluctant to see US predominance in too many industries, on the Canadian model. For as the proportion of US ownership goes beyond a certain critical range it becomes an influence for uniformity, instead of diversity, and a restriction of the range of choice.

It has often been stated that firms which might seem monopolistic on a national scale are not so when viewed as part of the international market. Even the new giant, GEC-English Electric has sales well below those of General Electric of America and is of

cannot the same results be achieved through association on a free trade area basis, or even through tariff cuts in the GATT? Indeed if Britain is to accept the EEC agricultural policy, this country might well have to enter at an exchange rate that gave home producers less price competition from overseas than they would have outside the EEC once the Kennedy Round reductions have been completed.

The usual answer of industrialists is that it is not so much the tariffs that matter, but the sense of belonging to a single home market in some institutional, political and psychological sense. It would, nevertheless, be rash to assume that a community, with the degree of payments disequilibrium which recently existed between France and Germany, is a single market in this wider sense.

From the point of view of the employee's range of choice of employment, barriers to movement are even

[5] *Capitalism and Freedom*, University of Chicago, 1962.

more important than tariffs. This is not only a matter of the right of establishment within the EEC or national migration laws. Rent controls or subsidized council housing, effectively put a tax on change of residence; their social aims could be more effectively achieved by giving grants to families rather than buildings.

6 Efficiency and intervention

The whole discussion on balancing the gains of larger units against the loss of competition presupposes that larger scale would provide efficiency in a country like Britain. The argument for this proposition is roundabout and devious, but is not necessarily false.

It is difficult to find any direct correlation between size and efficiency. A study by Professor Bain in the 1950s quoted by Caves found that if the average US plant was taken as 100, UK plant size in the median industry was seventy-eight. This is hardly a convincing explanation for comparative productivity, when we note that the corresponding figures for France was thirty-nine, for Canada twenty-eight and for Sweden thirteen. A study by G F Ray of the National Institute found no observable tendency for German export performance to be particularly superior to British in industries where German advantage in plant size was particularly marked.

Professor Caves suggests, however, that small scale interacted with high product differentiation and low capital intensity to produce a comparatively low level of productivity. A PEP survey has also shown a strong correlation among *firms* between size and both export volume and export expansion, although the relationship levelled off once the level of 1,000 employees was reached. This suggests that some further concentration may help to improve the terms of trade at which we can stay in payments equilibrium.

IRC has been at pains to disclaim any interest by promoting size 'in itself'. The view expressed in its 1968–9 Annual Report is rather that 'size, provided it is industrially appropriate and under effective management, can provide the essential base for the large scale of effort that is increasingly required to prosper in world markets and to proceed successfully to new generations of equipment'. This is not so very different from Professor Cave's parody, written earlier: find the most efficient firm and merge the rest into it.

These activities of the IRC have been accompanied by a parallel development in the work of the Monopolies Commission. The latter body has had since 1965 to vet the efficiency arguments advanced for mergers in order to balance them against the dangers of increased monopoly power. The new development is that the Commission is sometimes required to express a view on the efficiency aspects, even where it sees no serious threat to competition. It recommended in 1969 a ban on Rank's bid for De La Rue because it believed that the 'efficiency and trading volume' of the latter would be adversely affected, and not for any reason of monopoly policy.

There are two dangers in bodies such as the IRC or the Commission setting themselves up as judges of efficiency: the economic risk and the threat to the rule of law. The Monopolies Commission found that the proposed Unilever–Allied Breweries merger (now hanging fire) would do no harm to efficiency and might do a little good, while the Rank–De La Rue merger would have reduced efficiency. These conclusions do not follow at all clearly from the data in the Commission's reports. Someone looking at the latter might easily have predicted that the verdict would be the other way round. The Commission's view must have been based on subjective impressions not fully documented. The threat of departures of senior executives in a contested bid was the Commission's only important explicit argument—thereby establishing an extremely dubious precedent.

Three main arguments have been used by the Monopolies Commission and the Board of Trade for disputing the market's judgment on the merits of a bid or a takeover, which have nothing to do with monopoly policy:

1 In a contested bid the Commission may have more information than shareholders in either company.
2 Shareholders may pay too much attention to short as distinct from long term prospects in their market judgments.
3 Bids may be made for mysterious 'financial' or 'fiscal' reasons, unconnected with either efficiency or the exploitation of monopoly power.

The first argument at most suggests that the Commission should publish the information it has gained to improve the judgment of shareholders. (One should distrust unsupported judgments of the Commission made on the basis of information too secret to reveal.)

The second argument is more serious. I have no wish to argue that the rate of time discount thrown up by stock market prices provides a social optimum. Many economic theorists would argue that it discounts distant gains too heavily. My point is that if the Board of Trade or Monopolies Commission wish to introduce a different rate of discount, this should be announced and explained; and similar principles should be applied to different situations.

At this point the economic arguments link up with the 'rule of law' ones. The real danger of present official policy is not that the market is sometimes overridden; but that the fate of companies should depend neither on the market, nor on known rules of public policy, but on the unpredictable reactions of a shifting group of individuals invested with public powers. This is not a mere abstract fear of Austrian or Chicago economic metaphysicians. It is a serious matter when the fate of a company depends neither on the decisions of its management, nor on market prices, nor on known rules of public policy, but on the accident of whether Mr X happens to be sitting on the appropriate Monopolies Commission or IRC panel.

The danger becomes even greater when judgments about desirable industrial structure are laid down not even by the Monopolies Commission, but by Ministers of the Crown. An example was the President of the Board of Trade's temporary 'ban' on any merger among the 'Big Five' of the Lancashire textile industr or against any overseas takeover of the firms. Despite this ban he made clear that he had no objection to Courtaulds' plans for diversifying further into fibres.

The President's move did not [illegible]
principles concerning excessive [illegible]
The ban on any overseas takeover [illegible]
preserve competition in the industry [illegible]
hinder it. The 'standstill' was in fact [illegible]
intervention in a power struggle [illegible]
ter, Courtaulds, Viyella and English [illegible]
the Board of Trade came down against [illegible]
one issue, but in its favour [illegible]
Courtaulds'—unlike Viyella [illegible]
reason to be satisfied with the [illegible]
in June, 1969.

The supposed 'fiscal' or 'financial' [illegible]
over, unconnected with efficiency [illegible]
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of Trade pronouncements. [illegible]
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possible to deal with such [illegible]
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which the Board of Trade [illegible]
ger considerations.

7 The case for general rules

There is no reason to [illegible]
one value. The goal of a [illegible]
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'the mass of restrictive
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...n from a legal point of
...e *Restrictive Practices*

the public interest [illegible] discussed earlier, unless the management can [illegible] very good reasons why an exemption should be made. In an intermediate area — say [illegible] — a reference to the Commission should be automatic, while in the lowest band conglomerate mergers should be left to run their course. The [illegible] mentioned are purely illustrative; the method of valuation of assets would have to be specified, and there may be a case for alternative criteria in terms of turnover.

These suggestions are a rough first shot, but given in the hope that they will be improved or [illegible] in the course of discussion. Their weaknesses are grounds for amendment or improvement, not for a return to a [illegible] pragmatism.

3 Postscript on the balance of payments

In British Government pronouncements on monopolies and concentration, one constant refrain is the balance of payments. Potential gains in exports are among the grounds by which a restrictive practice might be justified under the 1956 Act. The supposed effects on the balance of payments may be dominant in the judgement of the Commission and in the public's choice of how to deal with [illegible]. The difficulty and expense of using the export gateway to defend an agreement under the 1956 Act was presumably one reason for the amending Restrictive Practices Act of 1968, which gave the Government power to exempt from registration certain restrictive agreements which it judges will promote efficiency, for the improvement of productive industry. In the debates on the 1968 Act, Government spokesmen were most reluctant to name export promotion specifically, but this may well have been for fear of attracting adverse international publicity.[1]

These attitudes are based on mercantilist illusion. Balance of payments deficits are the result of overvalued exchange rates or excess domestic spending, or both. If policy-makers are too [illegible] about international disturbances to want to rely on exchange rate and demand management alone, suitably chosen 'uniform tariffs' can supplement them and secure a balance at a lower volume but more favourable terms of trade. Once the view is taken that the prospect of almost any gain in exports can enable producers to escape the monopoly net, or obtain concealed favours of other kinds, the community is making a very bad bargain.

This can be demonstrated by examining the following extreme case: consider an economy with an overvalued currency divided into two sectors, one competitive and the other consisting of a single vast monopoly. The competitive sector does not export at all, because it does not pay it at the existing exchange rate to do so. The monopoly, on the other hand, does a particular deal with the Government. It exports as much as required to prevent a payments deficit [illegible] If dumping complaints can be avoided [illegible] at a loss. But it gains on the deal by being given a free hand to charge what it likes and remain free of anti-trust action on the home market. The resulting situation will be highly inefficient, because the goods exported will be those which happen to be in the monopolised sector, and not those in which the country has a comparative advantage. On top of this are the severe misallocation of resources for the home market, due to the price differential between the monopoly and competitive sector, and all the other social and economic disadvantages of allowing the vast monopoly to continue. All this misallocation and distortion could be avoided by establishing a [illegible] between exchange rates, productivity and wages which would enable our hypothetical economy to pay its way on a competitive basis.

There is only one oversimplification in the illustration that matters. As was mentioned earlier on, a large unit may find that it pays to engage in a world-wide marketing effort, which the equivalent number of smaller firms might not be able to arrange through specialist merchants and agents. In that case, faced with the choice between securing [illegible] a marginal [illegible] improvement in the balance of payments by allowing a merger and a fractional exchange depreciation, then the gain in the terms of trade from avoiding the depreciation might outweigh the other disadvantages of the merger. (We are considering here only mergers which would be barred, or at least not encouraged, in the absence of the balance of payments argument.) But the way to allow for the terms of trade effect is to assign some weight to the [illegible] of extra exports which can be achieved without [illegible] prices in overseas markets. Present procedures seem to assume that extra exports should be given almost infinite weight in a merger appraisal which cannot be justified if overall economic policy is rational. But even if the currency is overvalued, it is still better to assign a shadow exchange rate when evaluating the overseas profits expected from the proposed merger, than to allow anything through in the magic name of exports.

The most practical moral of this analysis applies to the Government's attempts to improve industrial efficiency via the IRC, the 'Little Neddies', Ministry of Technology, etc. These are at the moment being diverted into other irrelevant export-promoting or import-saving measures. Because the price mechanism has been deliberately put out of action in the balance of payments area, it is quite impossible to say how much of the industrial intervention is really required because of the sluggish and imperfect working of market forces, and how far it is simply being used as an inefficient backdoor substitute for the exchange rate. Specific industrial intervention would be more effective, and easier to justify, if it were not misused for jobs which other branches of policy are more suited to perform.

[1] See: *The Restrictive Practices Court and the Promotion of Exports*, a forthcoming paper by Charles [illegible].
[2] Subject to the qualification in [illegible].

1.4 A review of policies on monopolies, mergers and restrictive practices

T Wilson

There is little need to emphasize the complexity of the problems we have been invited to consider and this complexity, troublesome enough in dealing with a single country, is of course enhanced by the many relevant differences between the several nations rep- [illegible] to the UK with no more than some passing references to other countries which will no doubt be taken up and developed much further in the various groups. In so limiting the scope of this paper, I shall not, however, be asking you to consider only a single line of policy based on a single dominant philosophy and implemented by a single executive body. For, in this difficult field, Britain has chosen to meet uncertainty by covering most of the bets. The range and diversity of British policies can be illustrated by merely listing the principal institutions whose activities are relevant in varying degree to the matters before us: the Restrictive Practices Court, the Monopolies Commission, the Industrial Reorganisation Corporation, the National Economic Development Council and the little Neddies, the National Board for Prices and Incomes, the Industrial and Commercial Finance Corporation, the National Research and Development Corporation. To these we must add various ad hoc industrial inquiries and official policies based upon them (e.g. the Geddes committee on shipbuilding. Cmnd. 2937, 1966). Nor must we neglect altogether more general policies: the indicative planning of the Department of Economic Affairs, certain aspects of regional policy and certain aspects of foreign trade policy. Whatever the faults of British policy, it can scarcely be said to be lean, meagre or one-sided.

It is interesting to ask how an institutional structure of such rococo exuberance came to be created. At one time it looked to many economists as though a much simpler and more single-minded approach would be followed. If restrictive agreements before the war were often a natural, if inappropriate, response to deflation, then it was possible to infer that provided total expenditure could in future be maintained at a level roughly consistent with full employment, this would remove much of the pressure for agreements designed to sustain prices, to share markets, to impose boycotts and so on. Thus the new macro-economic policy could be appropriately complemented by a much more thorough-going attempt to strengthen competition throughout industry. It is true that this view was not universally accepted, but there can be no doubt that the progress made in fostering competition since the war has owed much to the success achieved in maintaining a high level of demand and employment. The fact remains that certain other policies with different objectives, some of them new and some of them closely related to those of the thirties, have also been adopted in recent years. It is interesting to see how this has come about.

Restrictive practices

A continuing, if muted, conflict of views about the desirability of competition caused the initial post-war [illegible] definitely to the support of competition. But there was still sufficient emphasis on the need for compromise to ensure that restrictive practices were not ruled out per se and provision was made for their defence under certain specified gateways. This proposed procedure was condemned in some quarters as too weak and too slow[1] but, given the objectives of the legislation, great progress has in fact been made. The vast majority of these registrable agreements have now disappeared, most of them undefended and the Registrar was able to say in his 1969 report that 'the mass of restrictive practices has been dismantled'. As a matter of historical interest, it may be asked whether the outcome would really have been significantly different if a per se approach had been adopted at the outset after the American model. The few industries which managed to put up a successful defence would have been affected—for good or ill—and, most important, a per se condemnation would have been resented as doctrinaire. Although the judgments of the court have varied in their severity and some strange rulings may have been made, its proceedings have demonstrated

[1] The procedure was not open to criticism from a legal point of view. Cf. R B Stevens and B S Yamey, *The Restrictive Practices Court*, Weidenfeld and Nicolson 1965.

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the difficulty under the Act of defending the relevant practices even with the aid of gateways that were originally criticised as being excessively wide.

We may ask at this point what economists expected to happen with the ending of agreements. The answer is less clear than might be supposed in view of the confidence with which the new policy was generally supported. For it is a familiar proposition of modern economics, that price competition is not to be expected in oligopolistic markets. If this is indeed the case, does it matter greatly whether there are restrictive agreements or not? For oligopoly is quite a common characteristic of modern industry and, if the dogma is true, then the most successful attack on price agreements by the Court will fail to restore price competition. In fact, of course, the proposition is not true, or rather is true only on the basis of narrow definition and restricted assumptions. It reflects an excessive preoccupation with the short-run, a deeply ingrained tendency to identify price competition with instability in prices and a neglect of inventory policy that is one of the more remarkable features of micro-theory. Just what is meant by 'price competition' or by 'free competition' is far from clear. Perhaps what is usually implied is an attempt by a firm to enlarge by price-cutting its share of the market for a commodity produced by a few firms all burdened with excess capacity. Thus it is inferred that the choice under oligopoly lies between, on the one hand, prices maintained at some more or less arbitrary level and, on the other, futile indeterminacy. But price competition may be defined more widely and more helpfully to mean that, even under oligopoly, competititive pressures can keep down both costs and margins. This pressure will often be felt most strongly when a product is being changed. Thus it can be misleading to refer to changes of this kind as an alternative to price competition when markets are oligopolistic. Changes in products may often be part of the mechanism of price competition rather than a substitute for it.[2]

We need not therefore suppose that there is some inherent feature of oligopolistic markets which will prevent price competition when price-fixing agreements have been abandoned; but we must recognize that the intensity of this competition may vary a good deal. A resort to price leadership is quite probable;[3] but this is consistent with varying degrees of competition. It could mean simply a new form of collusion to be used as a substitute for the older type of agreement—an inferior substitute no doubt because not enforceable at law but, for a time at least, a fairly effective one. But price leadership may not mean this at all. The position of the leader may depend upon competitive power and may be held precariously. The price leader is not necessarily the largest firm[4] and the identity of the leader may change fairly quickly. In short, price leadership may either be an inferior form of collusion or it may be one of the ways in which price competition operates.

Similar caution is required in passing judgment on information agreements. Such agreements may, admittedly, be a substitute for more explicit price-fixing arrangements of the kind now generally abandoned and may thus be used to restrict competition.[5] The possibility has been clearly recognized by the Registrar of Restrictive Practices, and the Restrictive Trade Practices Act of 1968 empowers the Board of Trade to call up various types of agreement for registration.[6] It would be possible to call up a very wide range of agreements on the understanding that registration need not imply subsequent disapproval or prohibition. The main advantage in following this course is to obtain as complete information as possible about what is going on. A possible objection is the administrative inconvenience of trying to be too comprehensive too quickly. But it must also be conceded that, in practice, registration will be taken to imply some disapproval and at least the danger of troublesome legal action. The effect may then be to discourage the exchange o information even when this would be socially beneficial and to encourage mergers.

If economic theory is to be helpful in passing judgment on information agreements, full account must be taken of the effects of uncertainty and defective information on business behaviour. Mr G B Richardson has laid great stress on this point and is one of the few economists who have drawn the inference that information agreements and even the proscribed price-fixing arrangements may be beneficial.[7] Many of his

2 There have been many complaints about the deficiencies of important parts of the theory of the firm. Cf., p. 4, Jack Downie in *The Competitive Process*. Duckworth, 1958, p. 19: '... economic analysis has failed to furnish a useful framework for thinking about problems of competition and restrictions on it.' Cf. also P W S Andrews' *Manufacturing Business*, Macmillan, 1949 and *On Competition in Economic Theory*, Macmillan, 1964. D P O'Brien and D Swann are critical of some existing theory in their book, *Information Agreements, Competition and Efficiency*, Macmillan, 1968.
3 Cf. J B Heath, 'Restrictive Practices and After', *Manchester School*, 1961. One of the best-known cases in Britain occurred in the cable industry.

4 Nor need it always be the firm with the lowest costs, as was shown, for example, by the MC's investigation of the rubber footwear industry. Cf. *The British Monopolies Commission* by C K Rowley, Allen and Unwin, 1966, p. 200.
5 Cf. D P O'Brien and D Swann, op. cit.
6 The *Board of Trade Journal* for 28 February 1969, explained that: 'The first call-up order proposed will extend to information agreements relating to prices, terms and conditions of sale and costs.' There have, however, been subsequent discussions with the CBI and particular firms which may conceivably affect the order and timing of the call-up procedure. The February statement contemplated the exemption of 'genuine schemes of inter-firm cost comparison'. It goes on: 'In a number of industries schemes of inter-firm cost comparison have been adopted similar to those conducted under the auspices of the Centre for Inter-Firm Comparison, with the objective of raising the general level of efficiency in an industry by showing firms taking part in the scheme what operational results their competitors are managing to achieve. The typical scheme of this kind involves a comparison not of prices but of costs expressed in terms of cost-ratios.'
7 'Price Notification Schemes', *Oxford Economic Papers*, November, 1967. His general theoretical position is explained more fully in his book, *Information and Investment*, Oxford University Press, 1960.
Messrs. O'Brien and Swann (op. cit., p. 234n) attack Mr Richardson from a rather intriguing angle by trying to direct against him an argument similar in some ways to the one advanced by Schumpeter (like Richardson a defender of restrictions) that temporary monopoly profits are an important reward for innovation. They argue that when ignorance is reduced by agreements to exchange information about prices, the reaction lag is reduced and the period of monopoly profits thus shortened. But, in so far as the lag argument is significant, it is more likely to be so with regard not so much to information about prices but to any exchange of information about investment intentions and, indeed, technological know-how. Their more substantial criticism of Richardson is to be found on p. 119.

colleagues may think he pushes the defence too far. The whole question of information agreements is, of course, a particularly topical one for discussion. An exchange of information about costs may help a firm to assess its efficiency and to base prices on 'normal' costs. But cost is an ambiguous concept in multi-product firms and there will be alternative ways of spreading overheads common to different products with a corresponding increase in uncertainty in oligopolistic markets. I suspect that this is one reason why explicit price-fixing is often desired by firms which nevertheless consider themselves to be competing among themselves. Is there an adequate justification [illegible]

after changes in prices had taken place? These might add little in the case of posted prices but would do so in the case of negotiated prices.

It is, perhaps, surprising that there is so little evidence of agreements to exchange information about [illegible]

to be restrictive. In its favour it may be urged that the risk of excessive expansion with consequent over- [illegible]

restrictive practices on the one hand and the central planning of industries on the other. Admittedly indicative planning for industries in general is now a less topical issue than it would have been a few years ago. Even in France, such planning has fallen a little out of favour. But in Britain there has been intensified official activity in attempting to alter the structure of particular industries, e.g. the work of the Little Neddies, Prices and Incomes Board and the Industrial Reorganisation Corporation.

Concentration and *mergers*

On general grounds it may be expected that a successful attack on restrictive practices will afford a powerful stimulus to mergers. This inference is not supported[8] by the decline in the number of mergers from [illegible] in 1964 to 598 in 1968 but may appear to be so by the vast rise in sums expended from £[illegible] to £[illegible] which is equivalent to about [illegible] per cent of the book value of the assets of manufacturing industry. Admittedly a simple post hoc, propter hoc argument cannot be conclusive even if attention is confined to the figures for expenditure. [illegible] at work. It is relevant to observe that there has also been a merger boom in the USA where legislation against restrictive practices is no new thing. Moreover the Federal Trade Commission keeps a sharp eye on the horizontal and vertical mergers that would be the natural response to the ending of restrictive practices and, in 1968, conglomerate mergers accounted for [illegible] per cent of the US mergers and 89 per cent of the money so expended. It is true that horizontal mergers have been relatively more important in Britain but it may be fairly assumed that in both countries other forces have been at work as well as official policy on restrictive practices. This is not to imply that the latter has been unimportant, at least in the British case.

Like the USA, Britain has its policeman in the form of the Monopolies Commission, but, unlike the USA, it has also its official procurer in the form of the Industrial Reorganisation Corporation. The respective roles of the MC and the IRC are one of the more intriguing aspects of official industrial policy.

The MC may, of course, investigate any case of concentration whether brought about by merger or not. The Board of Trade may refer to the MC 'monopoly conditions' which are deemed to prevail when 'at least one-third of the supply of a commodity is in the hands either of a single firm or of a number of firms which follow some restrictive practice'. The choice of this fraction and, more important, the definition of a commodity are interesting topics for specialized debate.[9] It may also be asked whether the MC should be encouraged to extend its investigation in appropriate cases to all the activities of a multi-product firm, not just to its 'monopolised' output.

The task of the MC would be a good deal more difficult than that of the Restrictive Practices Court if one could always accept at its face value the old proposition, familiar on so many old examination papers, that 'trusts (which bring economies of scale) are better than cartels (which do not)'. If a firm owes its dominating position to genuine and considerable economies of scale, the MC may have to decide whether [illegible]

that the monopoly position is really founded on economies of scale. Just as it would be wrong to suppose that cartels always eliminate competition between their members and thus fossilize the structure of the cartelized industry, so it would also be wrong to take it for granted that size is always based on efficiency — especially, perhaps, when the size has been achieved by merger.

[illegible]

[8] Annex to the report of the Monopolies Commission [illegible] Organisation [illegible] and the [illegible] 9 June 1969, General Observations on Mergers.

[illegible]

of such restrictive practices as control over retail outlets;[10] if so, these practices can be condemned and steps taken by the Board of Trade to end them. On the whole, the MC has, in fact, followed this course with reasonable consistency.[11] To this extent the apparent need to choose between low costs and competition can be evaded; but it is not possible, of course, to dispose of the whole problem of concentration in this way.

One of the most difficult tasks before any investigating body is that of assessing the economies of scale. If this assessment is to be made effectively it must be carried out at several levels: economies at the plant level, in research and development, in marketing, in the raising of finance and so on. Naturally there is no reason to suppose that a size of operation sufficient to achieve economies in one respect will be right for others. The ideal answer may not then be simply to resort to some sort of averaging compromise but rather to devise, if possible, an administrative structure for the firm or the industry which will allow these different optima to be combined in a reasonable way. Unfortunately it is one thing to lay down some general principles of this kind and a very different matter to carry out the quantitative studies required for their satisfactory implementation! We know very little about economies even at the plant level.[12] The evidence, such as it is, obviously justifies very large plants in some industries, notably steel; but it is unlikely that a high degree of concentration could be justified in many industries on the basis of plant economies alone. Even if our direct knowledge of plant cost-curves is limited, it is highly relevant that most of the large firms whose monopolistic powers have invited inquiry operate what is often quite a large number of plants. The critical economies of scale must therefore be sought in most cases at the level of the firm rather than the plant, and here the information available to us is even more nebulous. It is customary nowadays to lay particularly heavy emphasis on the advantages of size in research and development and this reasoning is no doubt valid in some industries; yet it is an interesting feature of modern industry that so many inventions have continued to come from small and medium-sized firms.[13] The large firm may have a greater advantage in development, though even here too the verdict is mixed. A great deal depends upon not only the nature of the product but also upon the way in which research and development is organized in both firm and industry. A large firm may have its research and development organized in an over-centralized way or it may have to simulate the advantages of smaller firms by much decentralization. The smaller firms, for their part, may be in a position to obtain outside support; and so on. It may be that the big firm has a clear advantage in marketing and this may be held to be particularly important from a national point of view in view of Britain's reputed weakness in marketing, at least in overseas markets; it is still necessary, however, to press for more information about the relationship between size and economies in marketing in particular industries. One would expect size to be a great advantage in advertising.

The industrial giant is, of course, at an advantage in raising outside finance; but it does not follow that it will achieve a higher return on capital than somewhat smaller concerns might do. The case for size, from a social point of view, can scarcely be securely founded on an alleged imperfection of the capital market on the side of the supply of finance.

A further important complication must not be forgotten. Consider the question of economies at the plant level. Larger plants may offer lower costs, with more-or-less given technical knowledge, in the production of given products. Over a larger period, however, we are concerned with the forces that shift the position of the cost curves and with the forces that encourage the invention and development of new products. Among these forces one of the most important is, of course, competition. There is an old but still relevant warning that the reward of monopoly may be an easy life.[14] Thus on the longer view it may be better to sacrifice short-run economies of scale (both at plant and firm level) for the sake of a more competitive and possibly more dynamic industry. This sometimes neglected point deserves to be emphasized. If the *unattained* economies of scale which a merger might offer amount to 5 per cent or so of manufacturing costs,[15] this will be equivalent to the effect of perhaps a normal year's growth in efficiency which would *lower* the cost curve by this amount. The arithmetic is only illustrative but it is clear that even over a period of a few years, forces affecting the *position* of the curves may matter far more than the economies of scale still to be achieved.

Admittedly such considerations are hard to assess and do not, of course, constitute a general case against size. My object is not to fabricate generalization from vagueness but rather to call into question the view that large scale nearly always means higher efficiency. I believe that this view has gained widespread acceptance, even if this acceptance is often implicit and has to be inferred from attitudes and policies. Few might wish to defend the proposition explicitly but many seem prepared to act as though it were unequivocally true.

Even a brief reference to these questions indicates the immense complexity of the task before a Monopolies Commission or any similar body in trying to decide whether a high degree of concentration can be justified by economies of scale. In the face of these

10 Since 1956, the MC can deal with restrictive practices not registrable under the Restrictive Trade Practices Act.

11 Another remedy is a reduction in a tariff. Cf. the recommended cut in import duties on cellulosic fibres of 10 per cent in the MC's *Report on the Supply of Man-made Cellulosic Fibres* (March, 1968). But this type of action raises wider issues of foreign trade policy.

12 Cf. *International Differences in Industrial Structure* by J S Bain. Yale University Press, 1966; *The Economics of Large-Scale Production in British Industry* by C F Pratten and R M Dean in collaboration with A Silberston. Cambridge University Press, 1965; 'The Merger Boom in Manufacturing Industry' by C F Pratten, *Lloyds Bank Review*, Oct, 1968.

13 Cf., e.g. *The Source of Invention* by John Jewkes, David Sawers and Richard Stillerman, Macmillan, 1958.

14 This has been well illustrated in some of the nationalized industries. It has been generally recognized that the independent airlines not merely provided alternative services but forced BEA to improve its own services. The case for competition in civil aviation would not be destroyed by showing that BEA was able to achieve fuller economies of scale than its rivals.

15 See, for example, the comments on economies in Mr Alister Sutherland's critical review: *The Monopolies Commission in Action*, Cambridge University Press, 1969.

difficulties some broad lines of policy may be suggested. First, every attempt should be made to ease the prob- [illegible] pondents might afford a model for the Monopolies Commission which might in turn seek to establish the same principle?[16] It need not be thought to be the duty of the MC to prove that detriment follows from concentration. Should it not rather be the duty of dominant firms to show that detriment does not [illegible] of concentration?

The question of the proper location of the burden of proof is clearly particularly relevant in dealing with mergers. Although so many mergers have taken place in the past, we know much too little about the subsequent effects on the structures of the industries concerned When it is a prospective merger that is [illegible] Commission nor the IRC should give their support to a merger unless they have been presented with as carefully formulated and reasonably detailed a plan for the proposed re-organization as can properly be attempted before the event? This would not merely permit a better assessment of the hypothetical benefits to be set against the detriment of more concentration; [illegible] For it is a fact too little recognized as yet in Britain, [illegible] manageable. Small mergers may sometimes be important however and the MC might be given freedom of discretion without being rigidly tied by a £5m lower limit as at present.

Mergers need not always weaken competition even when the mergers are horizontal or vertical. Situations can be envisaged where the joining together of some medium-sized firms may allow them to meet more effectively the competition of a large firm or firms[17] Naturally this reasoning begs the question about economies of scale; the need for evidence will still be paramount in each case. But, from another point of view, it is interesting that this proposition amounts to an admission that there may be real competition between *oligopolists* and *that this competition might* in some conceivable cases be made more intense by further reducing their number.

In the past, notably in the USA, there has been a tendency to regard vertical and horizontal mergers *with more disfavour than* conglomerate ones on the ground that the first two are more likely to reduce competition More recently there has been some shift of emphasis in the opposite direction on the ground that conglomerates may do less to raise efficiency and, for managerial reasons, may even reduce it. The new emphasis probably reflects the stronger contemporary emphasis on growth but is also clearly based on assumptions of fact that need to be more explicitly defended with regard to the horizontal and vertical mergers as well as the conglomerates. The latter un*doubtedly pose a difficult problem* They may reduce competition indirectly, as the MC observed in its admirably cautious *General Observations on Mergers*. But it must also be recalled that new entrants to a market are a powerful source of actual and potential competition, that these entrants will often be existing firms and that their effectiveness *may*, in some cases, be increased if backed by the financial strength of a conglomerate. There remains the more general objection that concentration of power in the hands of a few firms, whether conglomerates or not, can be car*ried too far It may also be held that if a firm has a lot* of surplus cash it should be more ready to make distributions to its shareholders instead of using its funds for managerial empire-building[18]

IRC and mergers

On the face of it one of the more paradoxical aspects of recent British policy has been the appointment of the Industrial Reorganisation Corporation which has as its principal activity the encouragement of mergers One cannot quite rationalize the position by saying [illegible] ficial. It is also necessary to demonstrate that some beneficial mergers may not come about quickly enough [illegible] Restrictive practices might do so; but these are already being dealt with in other ways Another familiar obstacle may be the problem of raising finance; but this is more likely to affect small and medium-sized firms Perhaps some of the activities of the IRC

[16] On this and related matters see Alister Sutherland, op. cit.
[17] The classical case was the proposed merger between the Bethlehem and Youngstown steel companies in the USA in 1958 Cf., e g *Competition, Cartels and their Regulation*, ed. by J A Miller, Amsterdam, North-Holland Publishing Co., 1962, pp. 236-7

[18] As I have said, the MC is very cautious in its *Observations* and does not offer much in the way of guide-lines. Can we go further than this? Should there, for example, be some tighter restriction on mergers (or takeovers) by means of an exchange of paper as distinct from cash?
[19] It is true that the IRC has observed in its annual report for 1968/69 (p 5) that size is not always an advantage and may even be a hindrance. The fact remains that the activities of the Corporation so far have been directed towards encouraging mergers and increasing the degree of concentration.

can be explained under this financial heading, but clearly not all of them. If a large, successful, well-managed firm such as GEC has a reason for wishing to absorb another large firm, such as English Electric, then the competitive superiority of GEC and the ease with which it can raise finance, should allow the process of merger to proceed naturally. One needs to know what grounds there are for supposing that natural processes would work 'too slowly'. If attention is diverted to smaller progressive firms which have more difficulty in raising finance, then two other institutions are at hand to help—NRDC and ICFC—as well as the merchant banks. It is not clear why a new institution is thought to be needed. A more convincing case can be made for special measures to facilitate the reorganization of traditional industries such as shipbuilding. I shall discuss later whether it is better to deal with these problems ad hoc or by means of a permanent institution such as IRC.

The IRC is not very explicit in its public statements about the reasons that have led it to foster particular mergers. Reasons are, of course, given but only in very general terms. One of these is the fact that the leading companies in particular British industries are substantially smaller than their American rivals in international trade. Such comparisons beg the question. For it is clearly wrong to make the implicit assumption that any US superiority is simply attributable to greater size.

It should be noted that this comparison with the USA usually relates to firms rather than to plants. Indeed an investigation carried out by Professor Joe S Bain[20] suggested that British plants in a range of manufacturing industries in the early fifties were not in fact significantly smaller than American plants. Admittedly this information is rather out of date and related only to a limited range of industries. It is also relevant to note that size is measured in terms of employment and measurement in terms of output would give a picture of substantially smaller plants in the UK.[21] A more general point of some importance is the need to take account of the size of an industry's market. With her much larger domestic market, the balance of advantage in favour of large firms in the USA will be different from what it would be in the UK, although foreign trade must be taken into account.

A more extended and more up-to-date comparison could, no doubt, be attempted and would serve to provide some prima facie evidence one way or the other. It must be recognized, however, that census-of-production data are presented under industrial groupings that, even at their most refined, are too broad[22] to serve as a satisfactory basis for operational purposes. Detailed specific knowledge relating to the two or more firms in question is required and such information is bound to be in a large part confidential. We are, therefore, faced with a basic difficulty in trying to assess IRC policy. Confidentiality must prevent the IRC from disclosing much of the relevant material even if available. We cannot say how much material has in fact been obtained, how it has been analysed or what detailed inferences have been drawn. Nor have we any at all adequate information about the extent to which the IRC has received from the merging firms adequately formulated programmes relating to the future structure of the enlarged concern. What is abundantly clear is that the IRC has placed great emphasis on management. This attitude has been described by Professor Richard E Caves in a passage which may have been received with only qualified enthusiasm in the offices of the corporation: 'These combinations embody a theory, now fashionable in the British government, which might be caricatured as follows: In order to achieve industrial efficiency, find the most efficient firm in Britain and merge the rest of them into it. Insufficient thought has been given to the objections, each supported by a good deal of general evidence: (1) the efficient firm may not remain efficient after absorbing its slothful brethren; (2) even if its efficiency survives the enlargement, it may rest on the transient presence of a management that is of but mortal flesh; (3) in industries with restricted or blockaded entry, mergers increase efficiency (if at all) only at the cost of an increased degree of monopoly. Although the Monopolies Commission has taken a reasonable view of these objections, the IRC has rushed to create industrial giants (and show the flag to the voracious American subsidiaries) with an enthusiasm worthy of the buccaneers of nineteenth-century American capitalism.'[23]

I must confess to personal bias in saying that I find any emphasis on the personal factor in management both refreshing and realistic in this computerized age It is clear enough, however, that it is risky to make long-term changes in the industrial structure at an intensified pace on the basis of an assessment of the efficiency of a managerial team in carrying out its existing tasks which will be substantially different from its new tasks after the merger. There is another point which must be made at this stage. In opposing the proposed takeover of De La Rue Limited by the Rank Organization Limited, the Monopolies Commission attached considerable weight to the strong opposition of De La Rue's managerial team. In doing so the MC incurred some public criticism and it has been suggested that to take managerial opposition into account as an objection to a merger was unusual and even eccentric. Such criticism seems to me quite unfair. If it is at all plausible to say that a merger should be fostered or at least permitted in order to extend the scope of good management, it is also surely

20 Op. cit., chapter 3.

21 It might be of some interest to debate which is (in principle) the right measure: output or employment. The answer presumably depends upon the questions one has in mind. The value of output is more relevant to considerations of financial power but measurement in terms of manpower may be more relevant to some at least of the questions relating to research and development.

22 This is not the only problem in using census material. Another is the great delay in obtaining the tabulated results. Thus the results of the 1963 British census were not fully available by 1969! I do not wish to imply any criticism of the statisticians concerned; they may not be to blame and the fault may lie elsewhere. Nevertheless the Board of Trade is not in a strong moral position to urge industry to reduce its delivery dates!

23 *Britain's Economic Prospects* by Richard E Caves and Associates, Allen and Unwin, 1968, p. 321. Cf. also MC Report on the Rank Organization Ltd and the De La Rue Company Ltd annex, para 28: 'Management quality changes and there is a risk of its deterioration, particularly when it depends on the enterprise and ability of a dynamic chief executive and there is no equally able successor in sight.'

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plausible on appropriate occasions to say that an efficient managerial team should be protected from absorption into a large conglomerate. The fact that the managerial argument is so generally thought to be reasonable in the one case but eccentric in the other is in itself an indication of the extent to which we have become unconsciously biased in favour of size

The National Board for Prices and Incomes

Although private price agreements have been generally abandoned, prices have not been left free to be determined by competitive market forces A new macro-economic factor has been at work. If deflation was the reason for many despairing attempts to sustain prices before the war, inflation has been thought to afford a reason for official intervention in order to keep prices down since the war. We are in danger at this point of being led into a discussion of the tangled issues of demand inflation and cost inflation, of the [illegible]

these general macro-policies. Indeed the 'micro' and the 'macro' are so interwoven that any attempt to separate them is likely to be somewhat artificial.

I shall, however, confine attention to one matter only: the attitude of the Prices and Incomes Board to competition as expressed in its Fourth General Report.[24] Paragraph 52 of its report is so important as to justify a lengthy quotation.

> Whether it be a private firm or a nationalized industry that is referred to the Board, the primary need is to devise a substitute for competition where the latter is lacking or insufficiently effective or cannot be restored The traditional policy towards the problem of monopoly has been to try to restore competition The fact has to be faced that this can rarely be done. A fully competitive situation requires that the market should not be dominated by any single firm or a small number of firms, that there should be no restrictive trading agreement, that the use of brands should not have been developed to such an extent as to segregate sections of the market, that consumers should have adequate means of exercising choice, that other firms are free to enter the market and compete, and that the firms do not have a single source of supply of any factor common to them all, with the result that if there is an increase in the cost of the factor everybody knows his rivals will pass it on in increased prices. Such a combination of circumstances is unusual and it may be impracticable or undesirable on other grounds to bring it about. The answer to this kind of situation is then an efficiency study In this sense we see an anti-monopoly policy being exercised through the extension into the private sector of the techniques of the efficiency study which we have begun to develop in the public sector.

This statement is clearly open to serious criticism. The influence of textbook teaching about so-called 'perfect competition' lies heavily upon it [25] It is significant that no distinction is drawn between a situation where a market is dominated by a 'single firm' and one where it is dominated by 'a small number of firms'. May we suggest that there is some failure here to understand the nature of competition (in particular price competition) in oligopolistic markets? The passage also raises an important institutional question Is the PIB the proper body to investigate situations of this kind? Would it be too uncharitable to suggest that we are faced here with the activities of a vigorous 'conglomerate' which are liable 'to fragment' still further the supply of advice about these matters?

Conclusions

The variety of government agencies operating in this field with different but related responsibilities is such as to suggest schizophrenia in high places. This impression may, of course, be quite unfair for we are dealing here with highly controversial matters about which different points of view may be properly held. A case can indeed be made for having, at the advisory level, a number of bodies which can be relied upon to represent in their varying ways the different points of view which need to be taken into account. This defence would not, of course, be valid if these [illegible]

bodies to behave with something of the independence of feudal fiefs. A question of no small importance which must, therefore, be put is whether there is really adequate administrative machinery in Whitehall for bringing together advice from these various sources and for formulating balanced and coherent policies Some attempt at co-ordination is believed to be made but this is a matter on which too little is known in public. We also know very little about what is done in the individual government departments themselves as [illegible]

referred to the MC,[26] the Board's selection may be entirely reasonable both in size and composition but little is known about it outside Whitehall.

Although a variety of advisory bodies can be defended, given appropriate conditions along the lines indicated above, the present arrangements give the impression of being a little confused and contradictory. Whatever may be thought about the need for more mergers and more rationalization in industry, there is perhaps a case for some mergers and some rationalization between the government agencies themselves. Whether a merger movement of this kind should extend to some of the industrial ministries as well as to their agencies is a further matter which cannot be explored here

May I, in conclusion, put forward tentatively a number of suggestions?

1 Price references relating to private industry should [illegible]

[24] HMSO Cmnd. 4130.

[25] *Competition as described by the PIB would presumably be* denounced by the IRC as an undue fragmentation of the market. 'Fragmentation' is the emotive word that is gaining in popularity

[26] *Monopoly and Restrictive Trade Practices* by G C [illegible] Allen Unwin, 1968, p. 128.

2 It would be presumptuous to suggest that the mergers so far encouraged by the IRC will yield no net social benefit. To assess each of these actions in turn would be a lengthy and detailed task and would call for much more information than is publicly available. The more central question for us to consider is for *how long* it can be sensible to proceed with an active merger policy of this kind. If this is to be its principal role, then IRC may have a useful life; but its life is more likely to be useful if it is fairly short.[27] There are already powerful forces at work which encourage mergers, in particular the British tax system. Mergers have been proceeding at a great pace and industry would become very highly concentrated indeed if this process were to continue. Is it not, then, commonsense to say that there is a grave danger in having a vigorous and highly efficient agency charged permanently with the task of encouraging further mergers? If the IRC, nevertheless, is to continue in existence, it should be required to free itself from any bias in favour of mergers. Should it, on the contrary, be positively instructed to consider whether, in certain cases, some firms may not be so much too large as to warrant being broken up on grounds of efficiency? Public funds could be made available, if appropriate, for alimony as well as for dowries. But this would carry the IRC so far into the field of responsibility of the MC that the case for 'market-sharing', if not for a 'merger', would become very strong. Would appropriate 'rationalization' confer upon the MC the full responsibility for recommending what should be done and upon the IRC the role of official 'merchant banker' charged with helping to implement policies which, in outline at least, had been determined by the MC and the Board of Trade.

3 It has been suggested above that there may be a special case for official action to facilitate mergers in certain traditional industries. When an industry has been in decline for some time it will have ceased to be attractive to capital or managerial ability. It will not be easy to raise on the capital market all the finance required for reconstruction on what may be a reduced but still viable scale of operation. Moreover in the traditional industry management is likely to be inbred and conservative, and managers with wider experience and a more up-to-date outlook would probably find themselves frustrated and inhibited if they were somehow to enter the industry with its structure unreformed. There may, therefore, be important cases where an official scheme for some rationalization, even backed by some public money, may be sensible and desirable. Would it not, however, be possible to tackle these problems ad hoc by specially appointed committees of inquiry rather than by relying upon the IRC? Can it really be held that such cases are sufficiently numerous as to outweigh the danger of having a permanent agency such as the IRC charged with what is interpreted as a permanent brief to encourage mergers? For a suitably modified version of Parkinson's Law may then be expected to apply: the number of officially sponsored mergers will expand to fill the time of those employed for this purpose.

It is always a matter of great difficulty to establish the facts about the economies of scale, the 'reasonableness' of profit margins and so on in particular cases. It will sometimes be the case that these tasks cannot be avoided; but there is a complementary approach which will help to meet the needs of the case without depending upon such hazardous calculations. This is to ensure that as far as possible policy is designed to make the market function with reasonable efficiency and without undue distortion. In the present context the most important issue is probably tax policy which establishes a formidable bias in favour of the retention of profits. It is a familiar observation that vigorous and ambitious boards of directors will then be tempted to take over other companies not only in those cases where there is a compelling industrial reason for doing so but also in order to find a convenient form of investment for surplus funds. The case for reforming the tax structure cannot, of course, be assessed from this point of view alone; but the effect on industrial structure is sufficiently important to afford a case for a critical assessment.

If the general line of reasoning in this paper is valid, it suggests that something much more radical is needed than the reform and rationalization of departments and official agencies. We also need, in my view, to review the basis of public policy with regard to both restrictive practices and concentration. Here, as elsewhere, Government has been very much more hostile to the former than to the latter. I have already referred to the dubious adage that 'trusts are less harmful than cartels'; but official policy seems to go beyond even this. For accelerated concentration would seem to be regarded as a general objective. It is not only that the attack on restrictive practices has—rightly or wrongly—been pressed home without regard for the danger that this may lead to more concentration. We have also been unperturbed by the fact that often institutional arrangements create a bias in favour of bigness. We have gone still further by establishing a powerful institution which has the fostering of new mergers as its principal role.

May I suggest that a switch of emphasis is now needed? No doubt it is right to call for the registration of certain information agreements. It would really be a little absurd, however, to launch a vigorous crusade against such agreements while remaining complacent about the growing concentration of industry. The stage has surely been reached when less attention should be paid to 'cartels' (open or conceded) and more to 'trusts'. The extent of concentration and the rate at which it has increased are illustrated by the fact that the net assets of the 28 largest companies accounted for 50 per cent of the total assets in the Board of Trade's sample in 1968 as compared with 39 per cent as recently as 1961.[28]

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27 This does not, of course, exclude the possibility that IRC might have other important roles.

28 Monopolies Commission, *General Observations on Mergers*, loc. cit., p. 34. There were 908 companies in the 1968 sample and 1,312 companies in the 1961 sample. These companies held not less than 80 per cent of the total net assets of manufacturing companies in the eight years to end-1968 (p. 33).

include (in para 35) the following comforting statement: 'There is no reason to think that merger activity has so far led to the growth of companies whose absolute size is such as to raise important questions for the public interest.' It is hard to know what precise meaning to attach to these words. When, and in what respects, would 'absolute size' be deemed by the MC to raise these questions? Such figures as those for concentration in the previous paragraph are to my mind ominous enough.

If I am right in saying that there is a general bias in favour of 'trusts' and against 'cartels', this may in part be a reflection of our ignorance of both. We know little, for example, about the extent to which competitive pressure remains effective within a cartel. We have certainly no right to assume that its more efficient and ambitious members will be content with policies designed to leave their least efficient members safe and secure. Nor do we know much about the effects of mergers, or about the internal organization of big firms and the effects these different structures may have. We are, perhaps, in some danger of being so mesmerized by the legal term 'firm' as to pay insufficient attention to the immense variety of different organizations to which that name may be applied. Consider, for example, the situation in an industry consisting of, say, half-a-dozen relatively important concerns and assume that, if they can, these firms will exchange information about costs, prices, investment plans and the like. Suppose now that the six firms are merged into a single one. The exchange of information between the different plants will be still more extensive. How far will the branch managers be allowed or encouraged to compete among themselves? Or to test the market by buying supplies or selling products outside the organization if this can be done on better terms? To what extent will rationalization be carried? To what extent *can* it be carried? What are the internal accounting arrangements? What will be the extent of cross-subsidization? And so on. A loose and impermanent confederation has been replaced by a single more permanent legal unit; but this may be operated in a highly centralized way or as a loose federation—with possible advantages and disadvantages in both cases. Is it, then, wise to allow policy to rest on the view that on balance cartels, or even information agreements, are generally more harmful than 'trusts'?

The discussion so far has been based on the implicit assumption that an objective of policy is maximum production of measurable output at minimum cost together with some less precisely conceived objective of fostering the development of new products. But there are of course other objectives. One of these is the development of the less prosperous regions within a nation. The requirements of regional policy may be thought to constitute an independent reason against concentration of ownership in the hands of a limited number of firms. But the importance of this consideration is probably slight. Industrial development in the regions has depended heavily upon the establishment of branch factories by large firms and will presumably continue to do so. The argument that these branches will be closed in bad times is usually greatly exaggerated. More significant is the argument that a

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[illegible] nation. The requirements of regional policy may be thought to constitute an independent reason against concentration of ownership in the hands of a limited number of firms. But the importance of this consideration is probably slight. Industrial development in the regions has depended heavily upon the establishment of branch factories by large firms and will presumably continue to do so. The argument that these branches will be closed in bad times is usually greatly exaggerated. More significant is the argument that a region will benefit more if it acquires not merely operational branches but also some other activities, in particular research and development. The likelihood of doing so may be adversely affected by mergers but the evidence is slight. A quite different point is that regional policy, in particular the control of factory building, may lead to an excessive dispersal of activities with some loss of economies of scale. This may, of course, occur whether or not there has been a growth or decline in industrial concentration at the level of the firm.

A far more important consideration is introduced by the argument that greater concentration, whether brought about by merger or large internal growth, is undesirable because it leads to an excessive concentration of power. This argument can, of course, be presented in such a way as to make the large firm appear to be a wicked ogre of 'monopoly capitalism'. In less extravagant but still erroneous terms it may be put forward in a way which ignores the amount of competition within oligopolies and overlooks the vulnerability of even quite large concerns to competition from new entrants. When these qualifications have been admitted it still remains true that a case can be made against too much concentration of power whether in private or in public hands.[22] I shall not try to assess the factual validity that lies behind such arguments but will content myself with saying that economists cannot properly rule out of account the value judgments which they also contain. In particular it is misleading to try to distinguish between 'economic' and 'non-economic' objectives. For 'maximum output at minimum cost' also embodies moral judgments as does any other recommendation of this kind. To bring in these wider issues may seem to complicate matters but really does no more than make explicit complications that are inherent in the nature of the subject itself.

It may be easy to become despondent if one is engaged in the practical application of policies designed to preserve and strengthen competition. It is certainly tempting, if one is an academic, to become cynical and to regard these policies as more or less futile attempts to remedy the endemic evils of the market under 'latter-day capitalism'. This reaction is wrong on two counts. First it implies an underestimation of the strength of competitive forces that has been partly engendered by the dubious static theory on which we have all been brought up. Secondly, it implies that there is some other unspecified alternative which would make it possible to avoid these irreversible ills and feeble remedies. It is, therefore, particularly illuminating to turn one's attention to the arrangement of production and distribution in Eastern Europe and to consider reasons for the reaction against highly centralized control. It is also interesting to observe that some of the problems of the West are also liable to be encountered in the East when increasing reliance is placed upon the market. If profits are thought to be a better measure

[22] It may be worth [illegible] that one of the reasons for de-[illegible] power [illegible] was to create a situation in which [illegible] participation in management could have more [illegible]

indicator than the fulfilment of physical plans, how can we be sure that these profits will not reflect the monopolistic power of a dominant enterprise, or the effect of collusion between different enterprises? How much information should be exchanged between enterprises in a country such as Yugoslavia? How are prices to be determined? How are plans for investment to be made? For some time the main emphasis has been on greater independence for the enterprise in making its investment decisions. Will this lead to over-investment in some cases and under-investment in others? Would the apparently desirable sharing of information about intentions lead to a less desirable sharing of markets? And so on. Of course there are important differences between countries. Of course ideologies create some real differences. The fact remains that the central problems of competition and monopoly are to be found, sometimes under different guises, in most industrial communities. The recognition of this fact adds immensely to the interest of the subject and serves as a defence against the superficial scepticism that might otherwise beset us.

1.5 Harmonization and co-ordination of market legislation: the concept of market law

U Bernitz

1 The problem

Under the heading 'Objectives of economic policy—the contribution of policies on monopolies, mergers, and restrictive practices', we shall primarily discuss the placing of anti-trust policy within the context of other accepted, major objectives of economic policy. In our mixed economies of today, industry and commerce are affected by so many kinds of legislation and other forms of government intervention that the *interaction* between the different measures constitutes a problem in and of itself. This problem is well-known in all countries represented here and is certainly regarded as important nearly everywhere. It seems, however, at least to a non-Englishman, as if the problem is especially crucial here in Great Britain

Board, the Industrial Reorganisation Corporation, the Economic Development Committees, and the authorities administering the new Trade Descriptions Act. Against this background, it is certainly not surprising that our British hosts want us to concentrate on the problem of *how to harmonize and co-ordinate the field*. Primarily, this involves questions of economics but it also seems necessary to study the *legal instruments* concerning market structure and market behaviour and their inter-relations. As a law professor, I find it natural to concentrate on this latter aspect.

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however, that it is not possible to consider in depth the

published in book form (in Swedish) this past Spring. The book is entitled *Market Law—A Comparative Study of the Development and Principles of Market Legislation.*[1]

2 Point of departure: the fundamental freedoms

From the point of view of the law, a market economy is circumscribed by a framework of legal regulation of economic organization and of the activities of business firms. The phenomena thereby controlled have, primarily, to do with the establishment of domestic and foreign enterprises, marketing and competition, and protection of the consumer.[2]

In the market economy system certain fundamental rights, freedoms, or privileges are discernible. Two frequently mentioned freedoms are freedom of trade and freedom of contract. These freedoms, however, are in themselves large concepts that embrace a number of other discernible rights. The most important of these, from the point of view of a business firm, include free entrance into the market, freedom to decide upon the location, nature, and range of business activity, freedom to compete with other firms, freedom to enter into agreements relating to purchases and sales, and freedom to incorporate and to form associations. From the point of view of the consumer, the most important right is the free choice of goods and services (freedom of consumption). The freedom to choose one's trade or profession and one's place of work should also be mentioned. To this may be added the demand for freedom to cross national borders.

The existence of these different rights makes the concept of *freedom of trade* ambiguous. It is often taken to refer only to freedom to enter the market and engage in trade without special permission from public

1 In Swedish: *Marknadsrätt. En komparativ studie av marknadslagstiftningens utveckling och huvudlinjer* (with a summary in English), Stockholm, 1969.
2 For a basic analysis, vide Nipperdey, *Soziale Marktwirtschaft und Grundgesetz*, 3. Aufl., Köln, 1965, pp. 'Die Geschäftsverweigerung im Recht der ungen', *Eine vergleichende Untersuchung chen Recht*, Tübingen, 1966, pp. 83 ff.

authority, although the concept may, at times, be broadened to include the freedom to compete in the market without hindrance from others similarly engaged.

A history of the evolution of law can scarcely avoid using the term freedom of trade. But in considering the present legal situation, it would seem useful to break up the concept into its parts and to define each of those as precisely as possible. Such an undertaking might of course, be pursued to various lengths. For the purpose of this presentation, it seems sufficient to distinguish between freedom of establishment and freedom of competition. These two freedoms are closely related but do not presume the existence of each other.

Freedom of establishment is used here to designate freedom of trade in the meaning first mentioned above. Freedom of establishment means the freedom to enter into the market and to engage in business without special permission from a public authority or from any other organization of an official, legal character.

Freedom of competition consists of the freedom to engage competitively in business transactions with other parties in the market. In other words, one has the freedom to inflict economic injury upon one's rivals in attempting to drive them out of the market.[3] Freedom of competition is, nevertheless, legally confined to competitive acts that are regarded as proper. Freedom of competition should, however, be more broadly regarded and should include the freedom to engage in competitive struggles on the basis of independent decisions which are not impeded by acts of other firms to restrain trade.

Freedom of competition likewise presumes freedom of action for buyers. The generally unrestricted choice enjoyed by consumers in the market constitutes such an important part of the market economy system that *freedom of consumption* ought, particularly, to be mentioned in the same breath with freedom of establishment and freedom of competition. In order for freedom of consumption to be fully realized, it is important that the consumer have access to comprehensive and reliable information pertaining to offered goods and services.

As has been mentioned, a second main principle of the system is *freedom of contract*. The competition for buyers' favour in the market presumes for its operation that there is freedom of contract. But freedom of contract, like *freedom of trade*, is a concept with many components. It is nearly impossible to imagine it free of restrictions.

The 'freedoms' that have been mentioned constitute rights that can ordinarily be characterized as the manifestation of general freedom of trade, commerce and industry in society. As has already been suggested, they cannot be preserved without modification even in an economic system that aspires to a very high degree of freedom of business activity in the market. This is all the more apparent in a mixed economy. In addition to being imperfect, the various 'freedoms' give rise to certain tensions which require a weighing of interest. A common example, which in recent years has increasingly been made the subject of legislation, is the misuse of freedom of contract on the part of the seller in his relations with the consumer who is said to be in a weak position in the market.

The conflict that can ensue in certain cases between freedom of contract and freedom of competition also deserves attention.[4] It proceeds from the fact that unrestricted freedom of contract also includes freedom for business firms to enter into agreements in restraint of trade.

3 Different instruments of government intervention

The basic rules relating to the freedom of establishment were developed early. From the time freedom of trade was introduced, rules concerning the establishment of domestic and foreign companies engaged in various kinds of activity and the restrictions to be observed have been needed.

The rules relating to marketing practices, competition, and the protection of consumers are for the most part of a later date.[5] At the turn of the century, regulation was often mainly confined to general rules of criminal law concerning, for example, fraud and to certain special rules. In addition, there were rather extensive laws protecting intellectual property rights. Freedom of competition, freedom of consumption, and an extensive freedom of contract appear to have been regarded as fairly obvious, though uncodified, premises for private laws; they were not seen as requiring close regulation. The law and, therefore, the law-making bodies focussed upon particular business transactions in the market.

Nowadays, as we all know, the situation is essentially different. The profound transformation of market conditions which has resulted from economic development—for example, the increase in mergers, modern marketing methods, and internalization of business—has required a large-scale expansion of legal regulation in order to control and to modify the conduct of the market.[6]

The interventions have not, however, always assumed the form of measures which result in a diminishing of freedom of activity in the market: they have also served to enhance competition. One seeks, in this way, to remove hindrances to inter-state commerce and to counteract restrictions of competition in commercial life.

From the legal point of view, many forms of governmental interventions are very loosely devised: this does not, however, necessarily detract from their effectiveness. Informal co-operation with interest

[3] This basic principle is stressed especially in American legal literature, vide, e.g. 3 *Restatement of the Law of Torts*, St. Paul, Minn. 1938, §708; 1 Harper-James, *The Law of Torts*, Boston, 1956, p. 517; Prosser, *Handbook of the Law of Torts*, 2 ed., St. Paul, Minn. 1955, pp. 749 ff.

[4] For a classic analysis, vide Eucken, *Grundsätze der Wirtschaftspolitik*, Tübingen, 1952, pp. 275 ff.

[5] A major part of my book Marknadsrätt, supra is devoted to a comparative examination of the development of these rules in English, American, French, German and Scandinavian law.

[6] For a general survey from American viewpoint, vide Wilcox, *Public Policies Toward Business*, Chicago, Ill., 1955 (or later ed.) ch. 1 and 2, cf. Edwards, *Maintaining Competition*, New York, N.Y., 1949, ch. 1; Rostow, *Planning for Freedom*, Binghamton, N.Y., 1959. From German viewpoint vide Huber, *Wirtschaftsverwaltungsrecht*, I–II, 2. Aufl., Tübingen, 1953.

groups and organizations, for example, commonly plays a significant role. By way of example one may refer to certain aspects of the British Prices and Incomes Policy. In Sweden, to take still another example, such co-operation has, in certain cases, given rise to 'agreements' concerning questions which are ordinarily the subject matter of legislation. One can also refer to public economic planning which entails joint effort between the government and the commercial sector on a still higher level. Swedish long range planning relating to the development of commercial life is, by and large, limited to economic prognoses which include economic-political recommendations of a general nature.[7]

The more strict forms of government management and control measures fall mainly within one of two categories.[9] The first category consists of interventions made for economic and political purposes as part of the general mode of operations. These interventions are intended to influence market conditions by altering various factors of fundamental importance to the formation of the market and to business conditions such as interest rates on investments, liquidity of business assets, and the purchasing power of the consumer. Such measures generally conform to the conditions and economic principles prevailing in a market economy.[10] Budget policy is of primary importance in this respect. The steps taken are, for the most part, implemented through legislation affecting the money and credit markets and through tax and other financial legislation.

The second main category consists of special governmental regulations pertaining to various market conditions. These regulations are sometimes termed 'physical controls' by economists. The interventions usually take the form of prohibitions or directives which those legally affected are required to observe in their relations with the government or with one another.

No sharp line can be drawn between the two main categories of governmental intervention. Experience has shown that it is quite possible to intervene by means of technically different kinds of legislative procedure which, nevertheless, achieve similar results. In certain cases the range and focus of a certain activity may, e.g. be managed by the imposition of special fees as well as by licensing prohibitions.

In modern economies intervention which may be said to have a directing influence is also employed. Such intervention surpasses the boundaries of more common forms of intervention without directly forbidding or imposing certain modes of operation vis-à-vis the subject of the regulation. Thus, for example, governmental influence may be employed to call attention to socially advantageous economic policies to be adopted by enterprises and by individuals by emphasizing the socio-economic ad[illegible]

[7] Elmander, [illegible], [illegible] pp. 184 ff.
[8] For a presentation of Swedish economic [illegible] see Lindbeck, 'Theories and Problems in Swedish Economic Policy in the Post-War Period', Am. Ec. Rev. [illegible]
[9] In Swedish economic [illegible] [illegible] 472 ff.
[10] [illegible]

vantages of such policies. Swedish labour market [illegible] a [illegible]. In [illegible] and to maintain full productive, and [illegible] public funds are employed for such programmes as post-retraining [illegible] and cash subsidies [illegible] labour [illegible] market [illegible]

Another example from the Swedish experience is the Government['s] [illegible] policy ([illegible] 1964) [illegible] special subsidies and loans [illegible] industries which establish and expand in regions having employment problems. This policy [illegible] general [illegible] localization. Thus it can be seen that regulations which take the form of [illegible] [illegible] accompanied by criminal and civil sanctions (fines, damages, etc.) constitute but one method among many for directing and controlling the relationships within commercial life.

Upon closer examination of these latter rules which are the focal point of this presentation, one perceives a more or less natural grouping of certain fundamental systems of rules. These provide the more general rules for marketing and competition and usually build upon laws of general and fundamental nature. One can, as a rule, distinguish four systems of rules. These are

1. the law of establishment (or business enterprise),
2. the law of restrictive practices and monopolies,
3. the law of unfair competition, and
4. the law of consumer protection.

To these can be added the system of [illegible] rules which have been developed in certain domains at the international level through an extensive array of conventions and treaties.

Let us now examine in greater detail these systems and their interrelations and systematic coordination.

4 Systems of rules

a The law of establishment

By the law of establishment we refer to rules which [illegible] and limit freedom of establishment. Freedom of establishment implies, as has been stated above, a basic freedom to enter into the market, following independent decision-making, to carry on a business activity, and to decide about the nature of the business, and its direction, scope and termination.

In several countries such as Denmark, Finland and Germany general establishment rules or laws, built upon the principle of freedom of establishment, are [illegible] together. To these are added more special [illegible] [illegible] which [illegible] forms of establishment. Examples of these latter laws are those which [illegible] [illegible] for the granting of authorizations, concessions, etc.[11]

[11] [illegible] the German [illegible] [illegible] [illegible] [illegible]
[illegible]

To a great extent, however, the law of establishment is composed of separate regulations affecting different commercial sectors, products, and forms of distribution. In Sweden, for example, one can point to regulations which apply to the production or distribution of special types of products such as explosives and combustible oil or to particular segments of economic enterprise such as scrap iron commerce, dealings in used materials and arms commerce.

There are many points of close contact between the law of establishment and other above mentioned norm systems. Legal limits upon freedom of establishment, for example, may be the results of deference paid to the interests of the consumer and to the interests of the community at large. Legal limits upon entrance into the market, which have the effect of limiting competition, may directly and/or indirectly seek to protect the market position of established economic enterprises. Governmental authorization decisions may also have the effect of limiting competition although they do not, in and of themselves, forbid the unauthorized from engaging in the activity in question.

(b) *The law of restrictive practices*

The fundamentals of anti-trust law are too well known to be presented here. In short, legislation against restraint of trade may be said to have as its main object the promotion of competition in the economy by eliminating or, at any rate, holding in check various forms of restrictive business practice. In certain countries its growth has sharply reduced former possibilities of restricting business activity in the market by means of trade agreements. Another main objective of this legislation usually is to make possible direct action against the misuse of a superior economic position. The relative importance of these two objectives varies from country to country.[12]

(c) *The law of unfair competition*

As stated above, freedom of competition includes, in principle, the freedom to inflict economic injury by driving competitors out of the market (through competition). Such activity can, however, hardly be regarded as unlimited. It is, for example, circumscribed by general criminal law measures such as the laws pertaining to fraud. There is, at the same time, a need for more strict rules for appropriate competitive measures than those which may be derived from the general criminal regulations.

Generally speaking, the system of rules against unfair competition has as its purpose the checking of dishonourable or otherwise unfair trade practices. These practices vary from one another. However, they are similar, especially when they are compared with the system of rules against restraint of trade, in that they are evaluated, in the first instance, on ethical and not on politico-economic grounds. The distinction is, however, not a fixed one; politico-economic views may be discerned behind rules against unfair competition and ethical views behind rules against restraint of trade. The kind of competition generally wanted is competition in performance (German: *Leistungswettbewerb*) and not a system where competitive advantages are derived from unfair measures such as boycotts and discriminatory practices (German: *Behinderungswettbewerb*).

Opinions as to which competitive acts are to be regarded as unfair competition vary markedly between judicial systems.[13] This is, in part, related to technical differences in the structure of the law, e.g. the relation to criminal law. One may find statutes, particularly in the area of advertising, in which other objectives play an important role (food products regulations, for example). However, the practices which are usually considered to be unfair competition include false or misleading advertising and other dishonourable marketing practices, defamation of a competitor, bribery and the acceptance of bribes in the course of business, and misuse of trade secrets or technical prototypes and instructions. Certain forms of clearance sales are designated, in many places, as unfair competition; so too are boycotts, in a number of countries. The latter form of activity is closely related to the system of rules against restraint of trade. A main purpose of the system of rules against unfair competition is often considered to be the extension of protection afforded to intellectual property rights. The unauthorized use of trademarks is a noteworthy example. Certain specified forms of imitation of intellectual achievement which is unprotected by the law of intellectual property (for example, an unprotected product design) are also usually regarded as unfair competition.

The lack of uniform opinion as to what should be regarded as unfair competition is related, in part, to the prevailing variety of opinions as to whether the

pp. 169 ff. (1965); Loussouaeu, 'Droit d'établissement', 3 *Rev. trim. dr. eur.*, pp. 62 ff., 859 ff. (1967); for Denmark Selmer-Ronsted, *Næringslovene*, Copenhagen, 1967; for Finland Uotila, 'Legal Aspects of Business Licences in Finland', 12 *Scand. Studies in Law*, pp. 255 ff. (1968); for Sweden Kungl. Prop. (Royal Bill) no. 98/1968.

12 For general discussion of basic objectives, vide, e.g. Kaysen-Turner, *Antitrust Policy. An Economic and Legal Analysis*, Cambridge, Mass., 1959, pp. 11 ff.; Merz, 'Kartellrecht—Instrument der Wirtschaftspolitik oder Schutz der persönlichen Freiheit?', *Wirtschaftsordnung und Rechtsordnung* (Festschrift für Franz Böhm,) Karlsruhe, 1965, pp. 227 ff.

13 The basic study of the international law of unfair competition and of the national law of the Common Market Member Countries is Ulmer et al., *Das Recht des unlauteren Wettbewerbs in den Mitgliedstaaten der Europäischen Wirtschaftsgemeinschaft*, I–V, Köln, 1965–68; vide especially part I (also available in French). Vide for English law, e.g. Marsh, 'Unfair Competition and English Law', *Int'l & Comp. L.Q.*, Suppl., Publ. No. 4, 1962, pp. 67 ff.; Thompson, 'English Law and the Concept of Unfair Competition', *Unfair Competition. Some Comparative Aspects...*, British Institute of International and Comparative Law, Series No. 12, pp. 48 ff.; Vide for American Law, 'Developments in the Law: Trade-Marks and Unfair Competition', 68 *Harv. L. Rev.*, pp. 814 ff. (1955), 'Competitive Torts', 77 *Harv. L. Rev.*, pp. 888 ff. (1964), 'Deceptive Advertising', 80 *Harv. L. Rev.*, pp. 1007 ff. (1967); cf. Callmann, *Unfair Competition*, I–V, 3 ed., Chicago, Ill., 1965; Vide for Scandinavian law Bergqvist, 'Project de législation nordique sur la concurrence délogate', 84 *Propriété Industrielle*, pp. 189 ff. (1968); von Eyben et al., 'Das Recht des unlauteren Wettbewerbs in den nordischen Ländern', *GRUR-Abhandlungen*, Heft 2, Weinheim/Bergstr., 1967 (also in *GRUR Int.*, 1964, pp. 233 ff., 263 ff., 300 ff., 358 ff.; 1967, pp. 191 ff. 292 ff.).

primary object of the rules is to protect the competitors or the consumers Both objectives may be discerned as well as mediatory tendencies in the law and practice of different countries. In those countries where the primary goal is the protection of competitors, the system of norms is commonly regarded as a related, uniform set of rules circumscribing the reciprocal conduct of entrepreneurs. Such a system is based upon commercial life's own estimate of which actions constitute inappropriate (unfair) competition and are, thus, unfair when employed against competitors.

However, there appears to be a progressive shift of emphasis, brought about by the rapid developments in the market place. There is an increasing demand for more effective consumer protection. A more highly developed system of norms seems to be needed in com- [illegible]

[illegible] consumer protection has, increasingly, come to the forefront.[14]

It should be observed that there are forms of prohibited competition other than those included in the system of rules against unfair competition. Competition can be restricted by the terms of a contract as much as by legislation. It seems helpful to distinguish between three principal forms of prohibited competition; competition contrary to law, competition contrary to contractual provisions, and competition resulting from unauthorized imitation.[15] The different forms of prohibited competition are related to legal rules of widely varying types which, in turn, are supported by different interests.

Competition contrary to law consists of those practices [illegible]

[illegible] concessions granted to private persons, and other restrictions of the establishment and conduct of enterprise. It is often a question of special rules of limited scope; for example, prohibition of a certain kind of transaction.

Competition contrary to contractual provisions is understood to mean competition contrary to a contractual obligation not to engage in competitive activity. We are faced here with a consequence of agreements entered into in restraint of trade. Under the law, the question is to what extent the restrictive provision may be permitted and legally enforced.

The term competition through unauthorized imitation may be taken to designate competition which involves intrusion upon copyright and industrial property [illegible]

exception to the general principle of freedom to reproduce and build upon someone else's ideas and accomplishments

(d) *The law of consumer protection*

Consumer protection is related to the systems of norms concerning the restriction of competition and unfair competition. Both of the latter systems aim, to a large extent, at consumer protection They do not, however, emphasize consumer information, description of goods, or rules calling for adequate labelling and disclosure in certain situations. A reason for this is that these measures, by and large, relate to rather recent developments (of the 1950s and 1960s) whereas the systems of norms just mentioned were developed earlier. However, there are close connections Consumer information and advertising may be said to constitute two forms of market communication They are directed to consumers and other audiences although they emanate from different sources (in one case from sellers on the market and in the other case from public and private organizations which serve as consumer representatives). One may also note that consumer information plays a competition-furthering role. It affords the consumer the possibility to better orient himself to the various items offered on the market and to their relative qualities Seen from this point of view, consumer information may constitute an important element of competition policy.

The latter half of the 1960s has witnessed an appreciable increase in consumer protection legislation in the form of rules and prohibitions related to market activity. This is especially true of American and British law One can point to the British Trade Descriptions Act of 1968 as an example. Steps have been taken along the same lines in several other countries as well, it seems that we are faced here with one of the major questions of the 1970s.[16]

(e) *Special regulations*

[illegible] suppose that the various fundamental rights may be enjoyed without restrictions in present-day economic systems.

[illegible] sweeping systems of regulations which affect whole branches of industry and commerce and which

[14] Cf *The ICC International Code of Advertising Practice* as revised in 1966.

[15] 1 Ulmer, op. cit., pp. 56 ff., 1 Roubier, *Le droit de la propriété industrielle*, Paris, 1952, pp 482 ff; cf 1 Gotzen, *Vrijheid van beroep en bedrijf § onrechtmatige mededinging*, Brussels, 1962, pp. 15 ff.

[16] The Final Report of the Committee on Consumer Protection, Cmnd. 1781, HMSO, 1962, has been internationally observed. For a survey of legislation on consumer protection in the Scandinavian countries, vide Jakhelln, 'Konsum entlovgivning i Danmark, Finland, Norge og Sverige', *Nordisk utredningsserie, 1968 6*, Stockholm, 1968

govern such fundamental factors as price levels and entrance into the market may also exist independent of emergency conditions. They may, for example, be implemented where natural prerequisites for competition are lacking or where such competition would appear unreasonable (e.g. 'public utilities' for water supply or for telephonic and telegraphic communication).

In addition, there are a host of special regulations of minor significance about which it is very difficult to generalize. These rules are not intended to substitute a highly prescribed system for competition. They constitute a conglomerate which can scarcely be systematized except according to industry or business or according to the sort of solution that has been arrived at, in different contexts, in regard to a certain problem. The substantive content of the rules pertains, overwhelmingly, to matters of detail, e.g. regulations of a sanitary nature.

The line dividing general from special rules is not sharp and clear. The special rules, for example a prohibition against certain retail sales techniques, presuppose various decisions which do not lend themselves to natural inclusion in a general scheme. In most cases, the difference between general and special rules is clear. The special rules, with the exception of emergency statutes, are usually limited to a particular commercial branch or question and are designed as complements or exceptions to the general rules to which they are related. Not seldom, special rules are limited in duration or are otherwise provisional in nature. A further characteristic of special rules is that they can usually be repealed without great difficulty and without resort to changes in the system of norms as a whole.

It is arguable whether special regulation should be relaxed in order to give competition greater leeway or whether special regulation should be enhanced on the basis that competition does not work well or leads to unjust results.[17] During the 1950s and 1960s, generally speaking, the trend was toward decreased regulation, both nationally and internationally, in accordance with the effort to further competition. A concommitant of this effort has been the greater reliance upon economic-political measures. This development should, in part, be seen against the background of the close connection between laws on restriction of competition and the special regulations. The latter bring about, as pointed out above, competition-restricting effects which in certain cases can be quite far-reaching and which may give rise to intricate problems affecting the co-ordination with legislation against the limiting of competition. Detailed regulations which extend over the greater part of commercial life, for example general price regulation, are, today, normally only resorted to as measures occasioned by serious inflation, balance of payments problems, or other acute economic difficulties. The experiences of Great Britain, Denmark and Finland serve as examples.

17 Vide [illegible] policy, e [illegible] 1as and Needs, *Das Unternehmen in der Rechtsordnung* (Festgabe fur Heinrich Kronstein), Karlsruhe, 1967, pp. 345 ff.; Rostow, op. cit. part III, Wilcox, op. cit. parts III–V.

(f) *International regulations*

The development since the second half of the 1940s toward greater freedom of inter-state commerce, brought about through reduction of customs duties and removal of other forms of trade barriers, has brought in its wake an intricate network of multilateral conventions and international organizations. This expanding and inter-weaving system has, in many ways, placed pressure upon the traditional framework of international law. There exists, today, great uncertainty concerning the approach of traditional legal institutions toward this new development. The suggestion for a new conceptualization in international law is voiced from different quarters. One can perceive the contours of a new systematics, deriving from the objectives and approach of legal regulation, which is leading to discipline specialization in international law not unlike that which has already taken place in national law. One can discern a type of international economics law and a related international commercial law.[18] In this connection one should mention not only the system of conventions which applies to international trade and payments but also the legal developments, in the form of arbitration awards and standard contracts, which are tied to the activity of inter-state financial organizations, the formation of legal development assistance programs, the multi-state owned companies, the great international enterprises, etc.

We have here a rapid legal development adapted to concrete needs and demands and evolved pragmatically in regard to individual situations. Systematization is made all the more difficult owing to the dynamic nature of these new developments. Within this expansive area, however, it is possible to distinguish certain systems of norms which have more clear contours and which centre around conventions of a fundamental nature.

Such a system of norms, which shall not be treated here, is related to the international regulation of currency systems and to capital and payments transactions from one country to another, i.e. those regulations relating to IMF and OECD conventions.

Another separate system of norms is related to multilateral conventions and international organizations which concentrate upon trade barriers directed against foreign enterprises and goods in order to give domestic commercial activity a superior position. The leading examples in this area are the GATT Treaty and the regional systems of norms which in Western Europe, derive from the Common Market and EFTA.

Obstacles to commerce, as is well known, are of different types. The tariff is the oldest, leading form. To this may be added other forms of import duties which do not, however, handicap domestic production in exactly the same way. Other principal types of commercial obstacles are quantitative import restrictions and indirect impediments which damage competitive conditions for foreign enterprises or whic limit inter-state commerce. Competition-distorting

18 Vide e.g. Friedmann, *The Changing Structure of International Law* London, 1964, pp. 152 ff.; Eck, *Folkrätten*, Stockholm, 1968, pp. 20 f., 444 ff.

measures can be effected both by governmental action (legislation or subsidies) and by action taken within the business community itself (different forms of restrictive competition).

An important form of government action to impede inter-state commerce is support measures which have the effect of distorting competition in the domestic market through the use of subsidies to domestic producers Such measures may also distort competition in foreign markets when they are attended with export subsidies (Subsidy here is intended to include different forms of bonuses, etc) Other obstacles are created where domestic production is favoured by government purchase of goods and where public enterprises discriminate, in other ways, against foreign commercial enterprises Inter-state commerce is further impeded when enterprises and individual entrepreneurs are not permitted to establish commercial activities in other countries on the same conditions as natives of those countries. Divergencies between the legal rules of different states on economically important points may also give rise to [illegible]

[illegible] of goods may check or impede the marketing of a uniform product in several countries Indirect impediments to trade may also arise from actions and procedures effected by the commercial sector (e g. contracts which are designed to restrict competition). Of even greater importance in this connection are agreements between companies and groups of companies in different countries which aim at division of the market. Such agreements on an international level may sometimes be regarded as substitutes for prior state trade barriers which have been overcome.[19]

The convention systems standardize the limiting and removing of obstacles to competition and provide a framework for freedom of economic enterprising and inter-state competition. They also serve to standardize the relationships on the international [illegible]

[illegible] international rules concerning direct trade barriers. Nowadays it is normally a matter of course that a country's domestic market is not divided through tariffs

[19] Vide for a basic study of the formation of international restrictive trade agreements, Kronstein, *Das Recht der internationalen Kartelle*, Berlin, 1967

5 The concept of competition law

There is still some uncertainty about the systematization to be used in locating basic market rules in the judicial system.

The general concept in common use in the United States is *trade regulation*. In practice, it is the law against restraint of trade (anti-trust law) that has [illegible]

[illegible] the legal aspects of 'die Wirtschaftslenkung', i e. the governmental direction and control of economic [illegible]

[illegible] ever, that a general part has already been provided through legislation aimed at the restriction of competition which expresses basic economic principles.[23]

Some authors regard the law of restriction of competition as part of Wirtschaftsrecht. However, it has been more usual, to date, to emphasize the connection between the law of restriction of competition and the system of norms against unfair competition. The two systems of norms taken together contain the legal standardization of freedom of competition (and its limits) and are often presented under the heading Wettbewerbsrecht (widely defined). Sometimes, Wettbewerbsrecht also includes trade-mark law. The term Wettbewerbsrecht, however, is also employed in a more restricted sense to mean only the system of norms against unfair competition.[24]

In France, the many different legal expressions for modern-day France's rather special government direction of market relationships are usually grouped under the rubric droit économique. Droit économique has vague contours; it is the approximate equivalent of Wirtschaftsrecht.[25] In French legal doctrine, [illegible]

[20] Vide, e g 77 *Harv. L. Rev.* pp. 800 ff. (1964) [illegible]
[21] Vide, e g Thompson, op. cit., pp. 48 ff.
[22] A fundamental, systematic work along these lines [illegible] op. cit.
[23] Cf Wiethölter, *Die Position des Wirtschaftsrechts* [illegible] *Rechtsstaat, Wirtschaftsordnung und Rechtsordnung* [illegible] Franz Böhm), Karlsruhe, 1965 p. 40 and [illegible] *Rechtsfragen der Planifikation* Stuttgart, [illegible]
[24] On the different concepts, vide Fikentscher, [illegible] *gewerblicher Rechtsschutz*, München, 1958, [illegible] Fikentscher, *Das Verhältnis von Kartellrecht* [illegible] *Wettbewerbs im deutschen und europäischen Recht* [illegible] europäischen Rechts (Festschrift für Hel[illegible] 1966 pp. 133 ff.; cf 1 Baumbach-Hefermehl [illegible] *Warenzeichenrecht*, 9 Aufl., Berlin [illegible] op. cit. pp. 3 ff.
[25] Savatier, 'La nécessité de l'enseignement [illegible] économique', *D Chron.* 196[illegible], pp. [illegible] public économique', *D Chron.* [illegible]

sometimes suggested that droit économique be developed into a form of enterprise law which would include the whole legal standardization of the position of the enterprise in the market, including company law and parts of labour law. This is, in part, an endeavour to create, in accordance with modern enterprise relationships, a suitable counterpart to the commercial law concept (*droit commercial*) with which one has traditionally laboured but which is largely grounded in merchant relationships.[26] Comparable suggestions can also be found in German legal circles; German commercial law is limited in a similar fashion.

The law against restriction of competition in France can hardly be said to be developed in as scholarly a manner as that in Germany. Legislation in this area is, without deeper and more systematic deliberation, usually regarded as a part of the wide area embraced by economic law (*droit économique*). During the 1960s, however, several scholars have emphasized the especially close connection between the law against restriction of competition and the rather dispersed French system of norms against unfair competition; together, these constitute 'the regulation of competition' (la réglementation de la concurrence).[27] The influence of German law, enhanced by French-German Common Market contacts, has probably played a role in this regard.

In the Nordic countries, there are few counterparts to Wirtschaftsrecht or to droit économique. A concept of competition law which is roughly equivalent to the German Wettbewerbsrecht has come into use especially in Norway and Denmark. It is possible, as in German law, to distinguish two meanings of the concept of competition law. On the one hand, one may discern a fairly broad concept that includes systems of rules pertaining to restraint of trade and unfair competition and, to a certain extent, to consumer protection and sections of the law of intellectual property. On the other hand, there is also a narrower concept which is confined essentially to the different laws against unfair competition, commonly called *konkurrenceloven* in Denmark and *konkurranseloven* in Norway. In practice, competition law is often treated as an adjunct of the laws pertaining to intellectual property.[28]

The configuration of the concept of competition law should be examined in light of the fact that the system of rules against unfair competition generally had been in existence several decades before laws against restraint of trade made their appearance. It was intended primarily to protect the competing parties. It is, therefore, not the laws against restraint of trade (which in Germany, and the Scandinavian countries, except Norway, are a product of the 1950s and 1960s) that have served as the beginnings of systematisation. The effort has, instead, been to find a place for this material in the structure already at hand; in this respect the system of rules against unfair competition has been found particularly attractive. This system of rules has, in turn, served to bridge the gap between the law against restraint of trade and the law pertaining to intellectual property.

Arguments can be given in favour of this configuration. It has been observed above that a connection exists between the system of rules against restraint of trade and that against unfair competition. Both systems have freedom of competition as their premise; together they form that part of the market's basic rules that function primarily to regularize the conduct of business firms in their competition with one another. The systems fulfil, generally speaking, the closely related main function of working towards competition that is free and fair.[29]

The connection between these two systems of norms is particularly evident in regard to marketing questions. The leading illustration of this proximity is found in American law. In the United States, as is well known, the same agency (the Federal Trade Commission) handles questions of both restrictions on competition and unfair competition without seeking to draw any sharp borderline between these two areas.[30] As further examples, one can point to several West European legal systems, such as the German system, which, in certain instances, regard boycott measures both as forms of competition restriction and unfair competition. In Swedish practice, many similarities have been found to exist between intervention against vertical restraints and intervention against misleading advertising and other unfair marketing activities. One can point to refusal to sell because of dubious business methods and the evaluation of so-called 'loss leader selling' of proprietary articles.[31]

The law of restrictive practices has, moreover, much like the system of rules against unfair competition, points of contact with the law pertaining to *intellectual property rights.*

These rights are also adapted to the conditions prevailing in a market economy. Certain generally recognized concessions are awarded to the holder of rights in order to provide him with a protected position in the market. In exploiting the market he enjoys a wide range of freedom to do business within the general limits of contractual freedom. The economic yield from a right depends on the value ascribed to it in the market. The form which legislation takes leaves, in principle, little room for testing its suitability or for allowing the public to contest any of its points in a particular case. Since intellectual property rights give the holder of rights a more or less secure starting position in the competitive struggle, without the intervention of regulations, they may be said to be shaped in conformity with the market.[32]

26 Vide, e.g., Champaud, 'Contribution à la définition du droit économique', *D. Chron.* 1967, pp. 215 ff.
27 Vide, e.g. Hémard, *L'évolution contemporaine de la réglementation de la concurrence. Etudes juridiques offertes à Léon Juillot de la Morandière*, Paris, 1964, pp. 203 ff.
28 For further information, vide Bernitz, op. cit., pp. 48 ff.

29 Penetrating analysis in Fikentscher, *Wettbewerb und gewerblicher Rechtsschutz*.
30 For an evaluation of FTC competition policy, vide Alexander, *Honesty and Competition: False Advertising, Law, and Policy under FTC Administration*, Syracuse, N.Y., 1967.
31 Bernitz, *Swedish Anti-Trust Law and Resale Price Maintenance*, Stockholm, 1964, 31 ff.
32 On the relation between intellectual property law and the law of restrictive practices, especially in Scandinavian law, vide Bernitz et. al., 'Industriellt rättsskydd och konkurrensbegränsning', 34 *Nordiskt Immateriellt Rättsskydd*, pp. 42 ff., 289 ff. (with summary in English).

The way in which intellectual property rights interfere with competitive conditions in the market and the way the particular form they take is determined in consequence of the competitive relationships in the market have, in part, found expression in their interplay with the system of rules against unfair competition.[33]

It is generally considered an important function of [illegible]

to supplement the laws pertaining to trade-marks and trade names. As has already been mentioned, it is also usual to designate as unfair competition certain specified forms of plagiarizing anothers' intellectual achievement not protected by the law pertaining to intellectual property; for example, an unprotected design. In this way, copyright law and design law have been supplemented in some measure.[34] There is also an intimate connection between the law pertaining to intellectual property, primarily patent law, [illegible]

possibility of intervening in a social situation by means of different kinds of legal techniques which achieve similar results.

Despite the interconnections in subject matter, it [illegible]

society as a whole. Legislation against restraint of trade and its enforcement constitute important tools of a nation's business policy in its general management and control of the market.

Legislation against restraint of trade generally has [illegible]

relationships with the law of contracts and of sales, the law of torts, company law, and labour law. It should be added that the great majority of restraints which, in practice, come under official scrutiny, have little to do with intellectual property law and related prohibitions against unfair competition. One may name such matters as cartels to fix prices and allocate markets, misuse of a dominant position in the market, and various types of vertical restraints of trade.

The traditional concept of competition law, with its close ties with intellectual property law, would also seem to be too limited with respect to the system of rules against unfair competition. As has been said above, a shift in emphasis in this field of law is taking place in response to rapid developments in marketing and the demand for effective consumer protection.

The law of establishment has, *so far generally not* been included in the concept of competition law. As was pointed out above, however, freedom of establishment has close ties with freedom of competition. Restrictions of the freedom of establishment, *whether effected through detailed government* regulation or through measures taken within the economy itself, amount to restraint of trade. Rules pertaining to laws of establishment should, therefore, be studied not in isolation but, in the first instance, as a branch of the legal regulation of market conditions in general.

Nor has competition law, so far, been much concerned with such matters as consumer information and labelling *of contents. Developments of the 1970s* will probably be in the direction of more comprehensive consumer legislation. Thus, it appears appropriate to work with a scheme which is wide enough to accommodate the results of future legal developments.

The special regulations discussed above have also been given little attention in competition law, [illegible]

formulation and scope, seem to bear a close resemblance to each other and to have a certain unity. They may be said to share the main objective of indicating *which patterns of action must be observed in the* operation of business in the market so that the market will function satisfactorily. All the separate business transactions of the producers and the consumers in [illegible]

6 Market law as legal discipline

(a) *Definition*

It will follow from the above that the general and special basic rules of the market are closely interconnected. It therefore appears proper to bring them together in a separate area of the law which would have an essentially wider scope than has generally *been conceived for competition law. To suggest this* change in primary legal structure does not appear drastic if one recalls the relatively limited currency of the concept of competition law and the uncertainty that has prevailed in the matter of systematization. It seems compatible with the general development in law in recent decades to look upon all the basic market rules as a whole. A concept with this configuration also has the advantage of being open-ended and capable of keeping pace with new developments in the law and in economic theory. [illegible]

33 A basic study of this interplay is Koktvedgaard, *Konkurrencepraegede immaterialretspositioner*, Copenhagen, 1965 (with summary in English).

34 However, this does not apply in all countries, e.g. in Sweden, no rule of this type prohibiting imitation exists.

law and enlarge its reference. This approach has its justifications. In an economy built upon market economy competition plays a fundamental role: all the rules which constitute the legal framework for the market may be related to some aspect of competition. The important systems of norms against restriction of competition and unfair competition are directly oriented toward the standardization of competition.

At the same time, this approach has its drawbacks. It does not seem quite accurate to characterize special regulations as legal rules of competition. Consumer information and consumer protection measures certainly seek to further competition in the interests of the consumer. Their primary objectives, however, are to inform and protect the consumer. The convention system which seeks to eliminate barriers to international trade is quite comprehensive. The term competition law is hardly adequate to describe this system as a whole. It is also quite conceivable that the term competition law will come to be regarded as programmatic.

It seems preferable to use the term *market law* (*droit de marché*, *Marktrecht*, Sw. marknadsrätt).[35] The term is brief and informative. It indicates that the function of the rules it covers is to regulate the market. It seems appropriate to take account of the terminology employed in economics and to call the area of law that concentrates on the regulation of market conditions (including marketing practices) market law. A term used in this connection is market legislation. It follows that *international market law* is well suited to designate the system of rules pertaining to trade restrictions between nations and related matters. It is unlikely that the term market law would be construed programmatically. Whether events conspire towards or against a general rise in government management and regulation and an increase in government-owned enterprise, there will doubtless exist national and international markets which, in order to function smoothly, will require market legislation and, hence, rules of market law.

Market law may be *defined* as that part of the legal system which seeks to standardize the pursuit of commercial activity and enterprising in the market place through rules relating to the establishment of enterprises, marketing, competition, and consumer protection. These rules might well be called the legal framework (basic rules) for the market for they all seek to specify the framework within which the market operates.[36] Individual market transactions, such as purchasing and other exercises of legal rights and privileges, occur within this framework.

It should, however, be pointed out that the border between legal framework and legal standardization of individual transactions is not a clear one. As has been pointed out above, it is often possible to intervene in a single social situation in different ways. Legislation concerning hire-purchase offers an example. The Scandinavian laws of instalment purchasing (dating back to the 1910s) focuses upon the individual purchase and provides rules intended to protect a purchaser, in certain instances, after he has acquired an instalment purchase good. More comprehensive legislation, in the same field, might very well emphasize the seller's side of such a transaction and, thus, might direct its rules towards instalment selling as a market activity.

The term market law is functionally defined and has its roots in economic and social realities. It is thereby to be distinguished from systematization based on abstract juridical concepts like the law of legal obligations and the law pertaining to things which has traditionally characterized property law and figure, e.g., in the evolution of the German civil code (Burgerliches Gesetzbuch, BGB).

Market law can be said, in large part, to be the heart of what is called Wirtschaftsrecht in Germany and droit économique in France, though these terms generally have a broader range of meaning. As their configuration is vague and their focus and purpose are controversial, it seems justified to distinguish market law as a separate discipline. However, it is necessary to observe and study its relations with other kinds of legislation of economic significance, e.g. legislation within the fields of tax law and finance or social welfare legislation. On the other hand it would hardly be advantageous to construct a Wirtschaftsrecht having the character of enterprise law, mentioned above, as has been advocated in France and elsewhere: such a programme would have the effect of severing natural legal interrelationships. It seems preferable to regard legal fields such as labour law and the law of associations as a unity.

(b) *Some characteristics of market law*

There are many bonds which hold market law together. The interplay between the systems of rules has already been mentioned. Market law rests on the common ground supplied by the fundamental rights, especially freedom of establishment, freedom of competition, and freedom of consumption. As has been observed above, the rules group themselves, in large part, around these rights. From this point of view, they may be regarded as rules which elucidate and modify these rights.

The market law in force, however, is not the product of a harmonious evolution of the law. Rather, it is the result of adjustments among separate economic interests and basic views as, for example, between producer and consumer interests. The power struggle among the various interests is complicated. There is, in general, no real counterpart in the context of market law to the part played by the consolidation of employers' interests in labour law. The starting point in market legislation is, on the contrary, competition and the resulting conflicts between business enterprises. The weighing of interests that lies behind the enactment of market law requires detailed, case by case analysis of the laws' intent.

A problem running through all market law, that

[35] As far as I know, the term has not previously been used in this sense.

[36] The rules could perhaps also be called 'rules of the game'. This expression, however, seems to refer primarily to the rules against unfair trade practices which makes it too narrow, cf. 1 Callmann, op. cit., 1 ed., Chicago, Ill. 1945, pp. 102 ff., 178 f.; Edwards, op. cit., pp. 2 f.; 1 Baumbach–Hefermehl, op. cit., pp. 39 ff., 1 Ulmer, op. cit., p. 31.

clearly reveals a difference in fundamental attitudes, is resolution of the conflict between economic freedom and regulation of business activity [illegible]

extremes are represented, historically, by the managed economy which was effectuated during the mercantilist period and the market economy (free enterprise) which epitomized the liberalism of the nineteenth century. The term regulation is employed here in its wide sense to mean both legislation and the restriction of competition in commercial life.

The debate is often carried over into the relevant literature. In his comprehensive work (1950s) concerning the German Wirtschaftsrecht, Professor E R Huber presents the conflict between freedom and regulation as the point which, by definition, unites the very extensive area he considered [38] The American economist Clair Wilcox, in the well-known work entitled *Public Policies Towards Business*, was successful in systematizing all the various policies by analysing their competition or regulation furthering objectives [39] This work covered all of commercial life. To attempt to include all of market law in such a scheme, in a legal analysis, seems, however, one-sided and extremely difficult.

The law's contours and the legal milieu itself leave their mark on market law. There is a tendency to allow the law to be formulated less stringently than is customary. This is accomplished, partly, by organs other than the general courts The Freedom of Commerce Board in Sweden is an example [40] Also worth noting is the tendency to set up 'councils' with quasi-judicial functions which are often non-governmental in character. This has occurred in the field of advertising, for example [41] An extensive system of rules pertaining to marketing has, thus, been developed, in many countries, within the business community itself through its own decision-making agencies. In a realistic study of market law it is necessary to note the way the law is formed and to observe the patterns of action represented by the operations of such councils. It is not only the relationship between legislation enacted by the [illegible]

towards the economic life of the community and business enterprises. This is especially apparent with respect to the law against restraint of trade, it can also be seen elsewhere, for example in decisions pertaining to questions of marketing practice. Detailed economic analyses are often a necessary first step in arriving at legal opinions and give rise, therefore, to the need for thorough-going, economic-juridical investigations.

What has been said thus far of the nature of market law is intended to point out the [illegible] in determining the position of market law [illegible] to *intellectual property law* It is [illegible] law, as defined in this study, cannot be regarded [illegible] some form of adjunct to intellectual property [illegible] can be argued that intellectual property law should be classified under market law This [illegible] based upon the exposition given above regarding [illegible] *place assumed in business by intellectual property* [illegible] and from its intimate connection with certain parts [illegible] the system of rules against unfair competition. Although there is reason to observe the connection between market law and intellectual property law, it appears to me to be important to treat them as separate areas of the law

Another question is how the system of rules against unfair competition should be treated Its two main objectives—to regulate marketing practices (especially advertising) and to supplement the legal protection afforded by intellectual property law—appear, in our time at least, to be disparate In my opinion, those parts of the law of unfair competition having to do with the regulation of marketing ought to be placed under market law The rules, relating to intellectual property law, against unauthorized imitation and misuse of trade secrets should be joined with and made part of intellectual property law Although these rules, in themselves, only prohibit competitive acts, such a division would appear most suitable from the functional point of view which has guided this systematization

(c) *The relation of market law to other areas of law*

The nature of the rules of market law, which provide the framework for the separate transactions in the market, is such that these rules strongly connect with the law of contracts and the law of sales [42] Economically speaking, sales constitute a branch, however special, of marketing There is, therefore, a close connection between the law of sales, on the one hand, and rules concerning advertising, consumer protection, and vertical restraints of trade (e g refusal to sell) on the other. [illegible]

dom of competition and consumer protection Naturally, a particularly close connection exists [illegible]

Market law also has a close connection with the law of torts. Freedom of competition includes, in principle, as was mentioned above, the freedom to inflict economic injury on one's rivals by driving them out of the

[37] Cf. footnote 17 supra

[38] 1 Huber, op cit., pp 10 f.

[39] Cf footnote 6, supra

[40] Bernitz, *Swedish Anti-Trust Law*, pp 15 f

[41] 1 Ulmer, op cit., pp 29 f., 57 f.

6—[illegible]

[42] Cf. Mestmacker, 'Uber das Verhaltnis des Rechts der Wettbewerbsbeschrankungen zum Privatrecht', 162 *Archiv für die civilistische Praxis*, pp 235 ff (1968), cf [illegible] *Recht*, Berlin, 1965, *passim*

[43] This relationship has been especially [illegible] vide 2 *Restatement of the Law of Contracts*, St. [illegible] §§515 9, 6 *Corbin on Contracts*, St Paul, Minn [illegible] 534 ff

market. However, nearly all present legal determinations in this field propose certain limitations upon this freedom, even within the framework of the law pertaining to damages, with the object of checking improper practices. Intensive boycotting is a common example. On this point, Swedish law is an exception: a consequence of a historic connection between criminal law and the law of torts which is retained even today.

There is also a connection between market law and the law of companies and other associations, in the first place with respect to the law of establishment but also with respect to the points of contact between the law against restraint of trade and association law. These derive, partly, from the fact that conspiracy in restraint of trade often occurs through special associations such as cartels.

There is also a connection, partly historical, to be observed between market law and labour law. Even though it is now general practice to regard the labour market as a special market, primarily regulated through its own system of rules and thereby constituting a special discipline, questions of definition can, nevertheless, arise; for example, when agreements in restraint of trade that are directed against the production market are made part of industry-wide collective bargaining contracts.[44]

The special character of real estate law leads to a natural boundary separating it from market law. Real property has a special character and has long had its own system of rules. The heart of this complex of rules consists of the law of conveyances, deeds and mortgages as well as various questions of property rights. Related to this, however, is the very extensive official management and control of the economical use of real property which has usually grown stage by stage in recent decades. Competitive conditions in the real estate market have also been subject to intervention. For example, in Sweden the law pertaining to acquisition of land for agricultural use, though developed as a law pertaining to requests for permission to acquire agricultural land, functions, in part, as a means of regulating establishment in the agricultural sector.

Finally, note should be taken of the relationship of market law to transportation law and insurance law; two special disciplines whose subject matter is functionally defined by their concern with two important sub-markets, the transportation market and the insurance market.

It is difficult to classify market law as either *private law or public law*. Seen as a whole, it is obviously neither one nor the other. The purpose of its system of rules is neither to regulate private rights and conveyances between private persons nor to constitute an exclusive instrument for the exercise of official authority. Market legislation fulfills the double function of serving as an instrument for society's management and control of market conditions and of proposing rules for the relationships among the various legal entities acting in the market. The first objective pertains to public law; the second to private law.

[44] Vide, e.g., Markert, 'Tarifvereinbarungen und Antitrustrecht', 15 *Wirtschaft und Wettbewerb*, pp. 922 ff. (1965).

Market law as a whole may be said to constitute a 'mixed' area of the law which contains elements of both private and public law.[45]

There are, however, differences between various parts of market law, above all between general and special rules. Many of the latter have, predominantly, the character of official regulation. The heterogeneous array of special regulations which are related to the general rules and which are meant to modify them should not, however, serve as the foundation for systematization. Instead, systematization should be based upon the fundamental systems of rules. The position taken in this respect by market law is not unique. There are other functionally differentiated areas of law which are 'mixed' in the sense that they, too, contain elements of both private and public law.

The problems concerning the boundary between private and public law are anything but new. The formulation of the problems, however, has been deferred in recent decades in consequence of the rapid growth of legal rules of a predominantly public law nature.[46] Legal history, in this respect, reflects social history. The mixing of private and public in the regulation of economic conditions constitutes the legal side of the economic system of our time with its mixture of market economy and government management and control.

As for the question whether market law ought to be studied within the framework of private or of public law, the answer cannot be in terms 'either or'; it must be in terms of 'both/and'. Market law, like other border disciplines, ought to be studied from the perspective of both private and public law. So far as research and teaching devoted to substantive law are concerned, however, it seems most adequate to link market law with private law and to treat it as a special discipline juxtaposed to intellectual property law and to other special subjects in private law, such as labour law and association law.

7 Conclusions

The forms which the organization and operation of economic life should assume are questions of unfailing interest to society. The scientific study of the fundamental problems involved is usually conducted within the disciplines of economics and of political science. In law, there is, generally speaking, a tradition of focusing one's attention upon the separate transactions that take place in the course of business activity as, for example, those transactions pertaining to sales. We must not, however, lose sight of the fact that the framework within which economic life functions is itself defined by law and gives rise to problems of far-reaching significance both in principle and in practice. The organization of an economy and the forms in which it functions are reflections of fundamental legal concepts of, for example, the law of contracts, of associations, and of property rights. They

[45] Cf. Wiethölter, op. cit., p. 61; Champaud, op. cit., pp. 218 f.
[46] Cf. Friedmann, *Law in a Changing Society*, London, 1959; Savatier, *Les métamorphoses économiques et sociales du droit civil d'aujourd'hui*, 2e éd., Paris, 1952, passim; Wieacker, *Privatrechtsgeschichte der Neuzeit*, 2. Aufl., Göttingen, 1967, pp. 539 ff.

are more directly regulated by legal rules which in various ways determine how much freedom of action is permitted in the market and which attempt to make the position of the consumer secure.

But as there is a substantial inter-play between these rules, it is appropriate to group them together and to view them as a unity. Such legal systematization is only a tool. As such, however, it is of great importance. Appropriate systematization facilitates research and study while less appropriate systematization can be obstructive and can have a negative influence upon legal development.

In my opinion, it is fruitful to regard market law as a systematic unity. This is especially the case today as the economic and political developments in the industrialized Western countries point to a continuation and an increase in legal normalization of the market. An important objective must be to insure that this development is satisfactorily effected from the standpoint of the law. Carefully drafted market legislation is necessary in order to preserve the competitive system in the long run and should be regarded as part of our society's basic legal framework

market. However, nearly all present legal determinations in this field propose certain limitations upon this freedom, even within the framework of the law pertaining to damages, with the object of checking improper practices. Intensive boycotting is a common example. On this point, Swedish law is an exception: a consequence of a historic connection between criminal law and the law of torts which is retained even today.

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There are, however, differences between various parts of market law, above all between general and special rules. Many of the latter have, predominantly, the character of official regulation. The heterogeneous array of special regulations which are related to the general rules and which are meant to modify them should not, however, serve as the foundation for systematization. Instead, systematization should be based upon the fundamental systems of rules. The position taken in this respect by market law is not unique. There are other functionally differentiated areas of law which are 'mixed' in the sense that they, too, contain elements of both private and public law.

The problems concerning the boundary between private and public law are anything but new. The formulation of the problems, however, has been deferred in recent decades in consequence of the rapid growth of legal rules of a predominantly public law nature.[46] Legal history, in this respect, reflects social history. The mixing of private and public in the regulation of economic conditions constitutes the legal side of the economic system of our time with its mixture of market economy and government management and control.

As for the question whether market law ought to be studied within the framework of private or of public law, the answer cannot be in terms 'either or'; it must be in terms of 'both/and'. Market law, like other border disciplines, ought to be studied from the perspective of both private and public law. So far as research and teaching devoted to substantive law are concerned, however, it seems most adequate to link market law with private law and to treat it as a special discipline juxtaposed to intellectual property law and to other special subjects in private law, such as labour law and association law.

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44 Vide, e.g., Markert, 'Tarifvereinbarungen und Antitrustrecht', 15 *Wirtschaft und Wettbewerb*, pp. 922 ff. (1965).

45 Cf. Wiethälter, op. cit., p. 61; Champaud, op. cit., pp. 218 f.
46 Cf. Friedmann, *Law in a Changing Society*, London, 1959; Savatier, *Les métamorphoses économiques et sociales du droit civil d'aujourd'hui*, 2e éd., Paris, 1952, passim; Wieacker, *Privatrechtsgeschichte der Neuzeit*, 2. Aufl., Gottingen, 1967, pp. 539 ff.

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1.6 The objectives of economic policy: the contribution of anti-trust

A Phillips

I Introduction

This paper surveys the role of anti-trust in the achievement of social objectives in the United States. In section II, anti-trust legislation and changes in anti-trust policy are examined to evaluate their development and their success as responses to expressed social goals. Section III deals with areas in which anti-trust has failed, both by achieving inappropriate policy positions in instances where it is applied and by its not being applied to numerous economic activities. Section IV briefly notes the growing importance of factors other than imperfections in competition in failures of the market system to function efficiently. A final section brings together the rather pessimistic conclusions concerning the importance of anti-trust in the attainment of social objectives.

II The origin, purposes and successes of anti-trust policy in the United States

Despite popular views to the contrary, anti-trust policy in the United States originated neither as evolutionary development of English common law nor as an obvious response to public outcries about welfare losses. There was, indeed, much discussion at the time of its passage of the Sherman Act being a legislative codification of the common law. But retrospectively, this discussion appears as hardly more than rationalization for a law which was pressed on the Congress by problems of legislative expediency and striking—if not compelling—criticisms from one wing of the press regarding the behaviour of 'big business'.[1]

The immediate reasons for the passage of the Sherman Act in 1890 relate more to the tariff issue than to the question of monopoly itself. Southern politicians, whose political effectiveness had been weak until then because of the effects of the Civil War, recognized that protective tariffs for manufactured goods worked against the economic interests of the South in maintaining and developing export markets for agricultural commodities. Joining the Southern (and Democratic) agricultural interests in opposition to the Northern (and Republican) desires for higher tariffs were the predominantly Far Western (and Democratic) 'free silver' interests, a number of labour-oriented groups and some Mid-Westerners who, in the tradition of the Granger movement, genuinely feared the evils of monopoly. With great political astuteness—at least for the short-run—the Republicans yielded to the cries for 'cheap money' by setting a higher price for silver. This was accomplished by passage of the Sherman Silver Purchase Act—but this was a far cry from 'free silver'. Similarly, they gave way to the labour groups, the Grangers and the anti-trust element of the press by passing the Sherman Anti-trust Act—but this was a far cry from the thorough-going anti-trust action being demanded. The new and higher McKinley Tariff Act of 1890 was, of course, passed.

American economists of the time were not generally among those demanding anti-monopoly legislation. In truth, economists such as Ely, Moody, Ripley and Clark became genuinely interested in the monopoly problem only after the Sherman Act had been passed and a number of now famous decisions had been rendered.[2] Prior to 1890, economics in the United States was heavily influenced by 'Social Darwinism'. To the eminent William Graham Sumner, the survival of only a few large enterprises in industrial markets was symptomatic of social fitness rather than of anti-social behaviour.[3] Moreover, even had the more modern view of the social costs of monopoly been recognized at the time, the economists would have had little impact. What economic objection there was

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1 The best history of the Sherman Act is H B Thorelli, *The Federal Anti-trust Policy: Origination of an American Tradition* (Baltimore, 1955). Another excellent study is W Letwin, *Law and Economic Policy* (New York, 1965). Both of these trace the common law background of anti-trust. Judge William Howard Taft relied on a detailed interpretation of this background in *United States v. Addyston Pipe and Steel Company*, 85 F. 271 (6th Cir., 1898), but the Supreme Court relied on the language of the Sherman Act and its views of the intent of Congress in this as well as other early cases. An expression of the view that the Sherman Act was primarily a response to public denunciations of the trusts can be found in O W Knauth, *The Policy of the United States Towards Industrial Monopoly* (New York, 1914).

2 R T Ely, *Monopolies and Trusts* (New York, 1900, 1902); J Moody, *The Truth About Trusts* (New York, 1904); W Z Ripley, *Trusts, Pools and Corporations* (Boston, 1905); J B Clark, *The Problem of Monopoly: A Study of a Grave Danger and of the Natural Mode of Adverting It* (New York, 1904).

3 For a number of quotations from Sumner's writings, see Thorelli, op. cit., pp. 113–15. Thorelli concludes that, 'The logical outcome of "survival of the fittest" thinking was monopoly, while the static analysis of classical economies envisaged a timeless equilibrium of perfect competition.' Ibid., p. 116, emphasis deleted.

to monopoly was founded more on its impact on equitable aspects of income distribution than on questions of allocative efficiency.

That the Sherman Act was not a response to an *overwhelming demand for anti-monopoly legislation* is further indicated by the early years of its enforcement. Paradoxically, suits by the government were for the most part brought against small businesses rather than the giant industrial trusts and combinations. Individuals and small businesses involved in coal mining,[4] lumber,[5] cattle dealing,[6] and cast iron pipe manufacture[7] were attacked. So, too, were associations of small railroads[8] and labour unions.[9] In the few instances when larger nationwide trusts and combinations were sued, the Act was ineffective [illegible]

American tradition' of anti-trust policy.[15] Before World War I, the Sherman Act had been used against vertical resale price maintenance practices,[16] and in breaking up significant monopolies or monopolistic practices in oil,[17] tobacco,[18] enamelled ironware,[19] and lumber,[20] and the arsenal of anti-trust was ostensibly strengthened by the Clayton Act of 1914.

This 'tradition', however, did not affect many markets, neither was it long-lasting. The zeal of the progressive era had waned by the end of the war. The formation of the United Shoe Machinery Corporation was held in 1918 not to be violative of the anti-trust laws.[21] In 1920, United States Steel escaped the fate of Standard Oil and American Tobacco.[22] The Supreme Court announced in effect that monopoly, so long as it was not accompanied with nasty practices which might injure other firms, was not contrary to law. The stress on competitors' welfare and the absence of attention to consumers' welfare in this and many other cases to follow is truly striking.

Labour continued to bear the brunt of the law, nonetheless.[23] So, too, did small lumber dealers[24] and sanitary pottery manufacturers[25] who, like workers, had difficulty in mitigating what to them seemed ruinously competitive market conditions. The oligopolistic farm machinery industry—in which consciously parallel price leadership completely stifled competition—was spared.[26] To read events such as these as contributions by anti-trust to reasonable objectives of a reasonable economic policy is most difficult.

The record of anti-trust in the 1930s is hardly better. With the Sherman Act already demonstrated [illegible]

stock acquisitions and subsequently alter the form to [illegible]

ducers' welfare was attended include at least one case [illegible]

Much of this softness in anti-trust was reversed in the years which followed. Price-fixing—even where [illegible]

anti-trust scrutiny.[32] Certain intra-enterprise [illegible]

[illegible]

[16] *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 US 373 (1911). Note, however, that del credere agency and consignment sales methods of distribution were used after this to accomplish the same purpose. The practice was later exempted from anti-trust where sanctioned by state laws.

[17] *Standard Oil Co. v. United States*, 221 US 1 (1911).

[18] *United States v. American Tobacco Co.*, 221 US 106 (1911).

[19] *Standard Sanitary Manufacturing Co. v. United States*, 226 US 20 (1912).

[20] *Eastern States Retail Lumber Dealers Association v. United States*, 234 US 600 (1914). Unlike some earlier and later suits, this case was an attack on a large, regional association handling all types of lumber.

[21] *United States v. United Shoe Machinery Co.*, 247 US 32 (1918).

[22] *United States v. U.S. Steel Corporation*, 251 US 417 (1920).

[23] *Loewe v. Lawlor*, 208 US 274 (1908); *Lawlor v. Loewe*, 235 US 522 [illegible]

mental difference between this legal view and the economic concept of monopoly is discussed below.

[27] *Arrow-Hart and Hegeman Electric Co. v. Federal Trade Commission*, 291 US 587 (1934).

[28] *International Shoe Co. v. Federal Trade Commission*, 280 US 19 (1930).

[29] *Appalachian Coals v. United States*, 288 US 344 (1933).

[30] *Old Dearborn Distributing Co. v. Seagram Distillers Corporation*, 299 US 183 (1936).

[31] *Interstate Circuit v. United States*, 306 US 208 (1939); *United States v. Socony-Vacuum Oil Co.*, 310 US 150 (1940); *American Tobacco Co. v.* [illegible]

conspiracies were recognized and condemned.[33] Market domination, with or without monopolizing behaviour of the sort missing in the 1920 Steel case, was held to be violative of the Sherman Act.[34] Tying agreements and exclusive supply contracts became virtually per se illegal under section 3 of the Clayton Act.[35] Group boycotts adversely affecting small enterprise were given similar status under the Sherman Act.[36] Finally — but only after the weaknesses of the Sherman Act were again displayed in a case involving US Steel,[37] — the Clayton Act was amended so as to yield a strong law against industrial mergers.[38]

III The inadequacies of anti-trust in fostering competition

A happy conclusion from this record would be that finally — some fifty or sixty years after its inauguration — anti-trust policy in the United States was effectively and judiciously controlling monopoly and monopolistic practices in a manner consistent with economic objectives. Unfortunately, this happy conclusion would also be an incorrect one. Anti-trust, despite its successes in recent years, still leaves the 'good trust' largely unaffected, still has elements that protect business interests at the expense of consumers, and still covers only a small segment of the market economy.

The 'good trust', as the words are used here, covers two sorts of market phenomena. One of these is a well-behaved firm so dominant in its market that no others would conceivably attempt overt rivalry with it. The other is a set of oligopolistic firms with absolutely no indication of an overt agreement on prices and yet absolutely no signs of price rivalry among them.

In the United States, the first situation is illustrated by General Motors' control of the market for diesel locomotives. From an economic point of view, the question of whether this is a monopoly which was 'thrust upon' General Motors by the ineptness of steam locomotive producers or is a result of monopolistic practices is quite irrelevant. It is a monopoly in either case and there is little reason to think the effects of it on allocative efficiency differ depending on which is true. Legally, however, it seems that a suit to divest GM of its diesel locomotive division and, perhaps, to break the division into a number of firms is not likely to be successful in absence of monopolistic behaviour.[39] Thus, the monopoly which does not threaten or coerce customers, suppliers or actual or potential rivals — that is, the classic monopoly which lives quietly with high prices based on a strongly inelastic demand curve and low cross-elasticities of supply — is immune from anti-trust prosecution. The doctrine of *Alcoa* does not apply.

The second type of 'good trust' is more common. It exists in numbers of industrial markets in which products are fairly homogeneous and the number of firms is small. The heavy chemicals and primary metals industries are illustrative. Under United States law if all that can be found is an identity of prices, with no meetings in hotels, no apparent tendencies to injure actual rivals or to exclude potential competitors and no such complexity in behaviour as would sustain an inference of overt agreement, the firms are safe. Again, so long as all they do is quietly injure the consumer by charging high prices, the doctrine of *American Tobacco* does not apply.[40]

The fact that injury to consumers is not a sufficient condition and that injury to other firms — particularly smaller ones — is sufficient for the condemnation of consciously parallel price behaviour points to another respect in which anti-trust policy is inadequate. The line between those circumstances where protection of business interests is consistent and those where it is inconsistent with protection for consumer interests has not been adequately defined. Two facets of anti-trust policy in the United States suggest that the prospects are bleak that the line will be more clearly defined in the future.

The decisions of the Supreme Court in *Brown Shoe*[41] and in *Von's Grocery*[42] show how particular business interests are placed above consumer interests in some — clearly not all — merger cases. In *Brown Shoe*, even while denouncing policies aimed at protecting competitors, the Court laid great stress on the fact that economies associated with vertical integration would hurt small, non-integrated retailers as the economies were reflected in lower consumer prices. The merger was apparently disallowed more for this reason than for fear of a future oligopoly.

In *Von's Grocery*, great social worth was associated with the retention of small and independent 'Mom and Pop' retail outlets, with virtually no regard for the fact that consumer behaviour reveals a strong preference among most buyers for the lower prices and wider varieties offered by the larger chain outlets. It is, of course, possible that the latter could merge into monopolies — conceivable even that that was wha

33 *United States v. Yellow Cab Co.*, 332 US 218 (1948); *Timken Roller Bearing Co. v. United States*, 341 US 593 (1951); *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 US 211 (1951).
34 *United States v. Aluminum Co. of America*, 148 F 2d. 416 (1945).
35 *Standard Oil Co. of California v. United States*, 337 US 293 (1949).
36 *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 US 207 (1959).
37 *United States v. Columbia Steel Co.*, 334 US 495 (1948).
38 The Celler–Kefauver Act of 1950 was the legislation. The meaning of the Act became clear only with the rendering of decisions such as *Brown Shoe Co. v. United States*, 370 US 294 (1962); *United States v. Philadelphia National Bank*, 374 US 321 (1963); and *United States v. Aluminum Co. of America*, 377 US 271 (1964). While the law is strong and clear with respect to all save pure conglomerate mergers, the total number of industrial mergers has continued to rise. The 1969 total will presumably far surpass that of 1968, and a post-World War II record was set in the latter year.

39 I judge this to be true because of the suit against the diesel locomotive monopoly having been dropped by the Justice Department.
40 *Theatre Enterprises, Inc. v. Paramount Film Distributing Corporation*, 346 US 537 (1954). '. . . [T]his Court has never held that proof of parallel business behaviour conclusively establishes agreement or, phrased differently, that such behaviour itself constitutes a Sherman Act offence. Circumstantial evidence of consciously parallel behaviour may have made heavy inroads into the traditional judicial attitude toward conspiracy; but "conscious parallelism" has not yet read conspiracy out of the Sherman Act entirely.' 346 US 537, at 540–1.
41 *Brown Shoe Co. v. United States*, 370 US 294 (1962).
42 *United States v. Von's Grocery Co.*, 384 US 270 (1966).

was likely in the *Von's* case—but it was not this danger which was singled out by the Court in its decision. The case hinges on the absolute decrease in the number of independent, owner-operated stores

The other facet of anti-trust where protection of business interests often is paramount to those of consumers is in the application of the Robinson–Patman price discrimination law [43] Consider only the approach of the Federal Trade Commission in the *Sunshine Biscuits* case.[44] Sunshine, the largest of the firms in the market, lowered its price for potato chips to certain large purchasers to meet a new price initiated by a rival. Sunshine had lost customers to the rival. When Sunshine dropped its price, it regained some of the previously lost customers and added some new ones *Illegal, the FTC held, because the price move by Sunshine could not have been in 'good faith' in these circumstances.*[45] A good faith lowering of price, in the FTC view, was restricted to those price moves which only retained old customers and did not gain new ones! 'Defensive', but not 'offensive', price moves [illegible]

Strangely, when the FTC is presented with discriminatory price behaviour with consequences broaching on those of a Sherman Act monopolization offence, it seems often to fail to recognize it [47]

Even if anti-trust did not suffer from the inadequacies noted above, it would remain true that the totality of policy toward competition in the United States is far from consistent As anti-trust rules on mergers, price-fixing and the like have become more clear and more easily enforceable over the years, the Congress and state and local governments have seen fit to exempt large segments of the economy from the anti-trust laws Exemptions have created what I have termed 'per se legalities' while anti-trust, where applicable, has been moving towards a per se illegality approach.[48]

The change in policy towards labour after the 1930s indicates the difference between the two. Until the passage of the Norris–LaGuardia Act of 1932 and the clarification of labour's position under anti-trust [illegible]

merce. Because the achievement of better wages, hours and working conditions usually depended on the unions' use of strikes and boycotts with precisely [illegible]

Since the change in policy, a full reversal has occurred The legitimacy of union activities does not depend in any way on the degree of monopoly power possessed by a union No matter how high the wages, how short the work week or how costly the working conditions being sought, a union cannot be threatened with anti-trust actions so long as it does not conspire with employers or restrict in some very egregious way the flow of commodities in interstate commerce.[52] Labour, that is, has been granted a per se legality so far as questions of labour monopoly are concerned

The same sort of treatment has been given other organizations. The Miller-Tydings and McGuire Acts permit resale price maintenance under the sanctions of state fair trade laws Agricultural and horticultural organizations have generally the same exempted status as do labour unions A variety of activities of co-operative agricultural marketing associations are exempt under legislation dating from *the 1920s and 1930s Agreements among firms* in industries regulated at the Federal level—including agreements to merge—are also frequently immune from the anti-trust laws

This is far from a full listing The Federal regulation of commerce is limited to that moving inter-state. Some states do have anti-trust laws covering intrastate commerce but serious efforts at enforcement are

[43] Decisions under the statute are so complicated and so inconsistent with one another that generalizations are difficult to make The two cases discussed are not at all unique, however Enforcement has, from a public welfare point of view, been unconscionably bad

[44] *Sunshine Biscuits, Inc*, Docket 7708 (1961).

[45] Under the decision in *Standard Oil Co. v. Federal Trade Commission*, 340 US 231 (1951), an absolute defence is established when a seller can show 'that his lower price . . . was made in good faith to meet an equally low price of a competitor'. But just what constitutes 'good faith' is far from clear

[46] *Sunshine Biscuits, Inc v. Federal Trade Commission*, 306 F 2d 48 (1962).

[47] [illegible] into a non-competitive pattern of pricing The possibility of monopolization, however, did not receive direct attention For a more detailed treatment of this aspect of the *General Foods* case, see A Phillips, 'Price Discrimination and the Large Firm Hobson's Choice in the Pectin Industry', 43 *Virginia Law Review*, 685 (1957).

[48] A Phillips, *Market Structure, Organization and Performance* (1962), Chapter IV. Concerning the difficulty in discerning whether per se has fully supplanted the rule of reason, Milton Handler says: 'I suppose it is no more irreverent to question whether the rule [of reason] is still alive than to inquire whether God is dead' See his 'Through the Anti-trust Looking Glass— Twenty-First Annual Anti-trust Review', 57 *California Law Review*, 182 (1969).

[49] *Apex Hosiery Co v. Leader*, 310 US 469 (1940).

[50] *United States v. Hutcheson*, 312 US 219 (1941)

[51] The words, 'per se illegal', do not appear in the decisions. For some labour practices, the effect was the same. In *Bedford Cut Stone Co v. Journeymen Stone Cutters' Association*, 274 US 37 (1927), it was held that, 'A restraint of interstate commerce cannot be justified by the fact that the ultimate object of the participants was to secure an ulterior benefit which they might have been at [illegible]

[52] [illegible] from the exercise of monopoly power that are ignored In *Local Union No 189, Amalgamated Meat Cutters v. Jewel Tea Co*, 381 US 676 (1965), the labour agreement in effect prevented the sales of prepackaged meats to supermarkets. In addition to the direct exclusion of these goods from the market, the agreement tended to prevent competition between small butcher shops and the supermarkets. These effects were not adequate to violate the anti-trust law.

rare. On balance, state and local government policy is anti-competitive rather than pro-competitive. Numerous businesses and occupations have licensing or registration requirements which impede entry and stifle sources of potential competition. Building codes, ostensibly developed for reasons of health and safety, often favour local crafts and businesses. Even the zoning of real estate may be manipulated to deter the entry of new businesses which would be competitive with existing ones.

With state and local immunizations from anti-trust considered, only a small part of the national product of the United States comes from sectors where anti-trust applies in full force. Even in these sectors, anti-trust is not uniformly applied so as to foster competition. Thus, to the extent that competition is compatible with and conducive to the objectives of economic policy, anti-trust has made only a minor contribution.

IV The growing irrelevance of anti-trust

It is not hard to understand why public figures from, say, sparsely populated areas of Arizona tend to be libertarians in their approach to economic policy. Government regulation is less necessary to protect people from costly 'neighbourhood effects'. One can play his stereo as loudly as he wishes; no one else is within earshot to be troubled by it. One can burn his trash and pollute the air; by the time the wind has carried to others, the smoke is quite unnoticeable. One can speed in his auto across intersections which have no stop signs; the probability of there being another coming on the other road who might be injured is small.

In this world—if it can conceivably be structured competitively—markets work well. The full costs and benefits associated with the decisions of firms and individuals are felt internal to the decision-making unit. Externalities—that is, costs and benefits felt by other firms or individuals and which are not considered in the cost-benefit calculus underlying decisions—do not exist in great number.[53]

Most people live in more densely populated places than Arizona. They utilize both as producers and consumers a variety of modern technologies which have strong neighbourhood effects. While policies akin to anti-trust might in some circumstances be used to restructure markets so as to 'internalize' the externalities of an existing structure, for the most part anti-trust is irrelevant. Where external costs or benefits exist, promoting competition need not be conducive to improvements in allocative efficiency.[54]

A glimpse at the categories of externalities indicates the magnitude of the problem. First—and the classic case—are the Marshallian–Pigouvian externalities. Industries may have increasing or decreasing costs if certain cost elements vary with changes in aggregate industry output but not with changes in the outputs of individual firms. Where this is the case, the marginal costs of the separate decision-making units do not reflect industry (and social) cost conditions and either too little or too much output is produced. This problem, it can safely be assumed, is not a cause for major current concern.

Second, there are firm-to-firm externalities. If plants upstream use a river for waste disposal and plants downstream require pure water as an input, the private costs of the former are less and those of the latter, more than the social costs of their respective outputs. This sort of externality, it can be argued, is important and growing and offers little hope for solution through anything like anti-trust policy.

Third, there are firm-to-individual externalities. Water pollution reduces the satisfaction of consumers in recreational activities. Air pollution causes deaths and disease as well as it induces the costly use of air filters and air conditioners. Aircraft noise is disturbing to persons and, in the extreme of a sonic boom, damaging to property. Again, technology seems to provide ever new ways to create such externalities and, without some form of regulation, to give ever stronger inducements for firms to 'beggar-their-neighbours' by transferring more of the cost burden to others.

Fourth, there are individual-to-individual externalities. One person expectorates—presumably for his own pleasure—and another gets influenza. Many persons use automobiles and the resulting exhaust fumes increase the incidence of lung cancer in others. One person plays 'rock music' loudly and his neighbour's satisfactions fall. To what avail is anti-trust in economic policies aimed at correcting such divergencies between private and social costs? Obviously, virtually none.

Finally, there are the externalities associated with public goods.[55] For these it can be taken without argument that anti-trust is irrelevant. But, as with the other classes of externality, it appears that they are growing in importance. As they grow, policy instruments other than those fostering competitive market performance become more essential in the achievement of economic objectives.

V Conclusions

Anti-trust policy in the United States has not, it seems, been quickly responsive to even the economic objective of maintaining competition. Where the policy has been correct, it has been very slow in its development. Moreover, the policy has not in all instances fostered competition. The preservation of particular competitors rather than of competition has resulted in some instances and there are no signs that this aspect of anti-trust will soon be changed. On top of these failures, only a small portion of all economic activity is subject to anti-trust rules and, because of externalities, in only a decreasing portion of such activity can it be expected that unregulated competition will serve as an efficient allocative device.

53 Even in Arizona the law steps in where neighbourhood effects are pronounced. The dry western states give strong riparian rights to landowners to prevent other owners upstream from using all the available water.

54 For an excellent treatment of this, *see* F M Bator, 'The Anatomy of Market Failure', *Quarterly Journal of Economics* (August 1958).

55 'Public goods' have the characteristic of being indivisible in consumption in the sense that making them available to one person necessarily makes them available to others.

this posture.

Despite the worry that anti-trust may have been subverted by establishment values and of the consequent worry that its failures to achieve economic

seated and popular anti-establishment feeling that nobody should get 'too big for his britches'.[57] That is, its underlying social purpose was to prevent establishment values—whatever sort of establishment—from becoming so firmly entrenched in the political and social fabric that change is possible only through revolution.

Anti-trust, I believe, has been worth at least its costs if it has done no more toward social objectives than help in a minor way to keep a spark of this idea alive.

Group 2
Firm behaviour and policies on monopolies, mergers and restrictive practices

2.1 Chairman's report

D Henry

Group number two dealt with firm behaviour and policies on monopolies, mergers and restrictive practices We are fortunate in having first of all four good papers covering a very good range in this field A paper by an American professor, Professor Markham, we had Dr Benisch from Germany, we had Mr Leyland from the United Kingdom and we had Professor Kanazawa from Japan. With that background we had a good discussion also, with good participation by the members of the Business Community or their advisers who are in our midst, and this being a subject which concentrates on the behaviour of the firm, much of what I have to say will reflect information that came out in the discussions about firm behaviour from the practical stand-point of the business man and his adviser. Obviously there was a difference of view as between the business men, the officials and the academic community, and there was another difference, quite obviously. The effect of the anti-trust laws, and anti-monopoly laws, the restrictive business practice laws, whichever you wish to call them, depends very much upon the country, the jurisdiction, in which the firm finds itself.

First of all, we had it pointed out that there was a problem of methodology here; how does one go about [illegible]

on, but they of course are isolated cases—you need a lot of them to draw conclusions—and thirdly there is empirical research—we had the impression that there is very little in the way of data produced by empirical research. Now a general point about attitudes towards *competition and competitive pressures which is mentioned* as a subject in the book in front of us. There is no denial that competition is the fundamental regulator of the market economy, and that profits are the driving force of the firm. It seems to be generally accepted, nd the general view was, that state regulation or state intervention should be kept to a minimum. There was strong opinion, on the part of some anyway, in the absence of restrictive practices laws, firms will substitute monopoly and restrictive agreements *for competition. That seemed to be a commonly held* view by expert speakers on all sides. In the United States, the anti-trust cases have revealed overwhelmingly empirical evidence that this was the case before the laws prohibited it In the United Kingdom, the Restrictive Practices Act resulted in the registration of over 2,000 restrictive agreements, so there is evidence of restrictive agreements here, and in Germany we were informed that price cartels were common before the prohibition was enacted under German Law. The view was expressed that in the US case logical analysis revealed that oligopoly will develop where there is no restraint on co-operation among competitors and that oligopoly with co-operation approximate monopoly. We had a business man's view expressed to the effect that, and this was not contradicted, there is the acceptance that some restrictive practices are bad per se such as the price fixing agreements, and there must be some control of monopoly and scrutiny of mergers. From their standpoint this was a *fact of life and the firm must learn to live with it.*

There are limitations on our information about firm behaviour; there is a lack of information as to motivations of the firm, or the objectives of the firm. There are various possibilities, the possibility of profit maximization which it was pointed out to us was too simple a proposition; it was also explained to us quite firmly by one of the participants that his firm goes for [illegible]

anti-trust laws in the United States merely alter the [illegible]

not necessarily maximize profits but analysts have found it convenient to assume some such *meaningful* objective. In practice, this may not be exactly what the objective is Our lack of information as to the basis of particular decisions of the firm leads us to conclude that there should be more empirical research done in this area. It was thought in our group that we need a *study on relationships of the firm* with the public, with the shareholders, with creditors, with Government. The motivation of the firm, and what leads to its decisions, involves complex [illegible] affect management and it is [illegible]

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told, to isolate one factor, such as the restrictive practices laws, and draw conclusions without more knowledge of the impact of other factors. In that background we proceeded to try to work our way through the subject.

Assuming the general proposition that I stated to be correct, then it was put forward and not generally challenged, that policies and laws restraining monopolies, mergers and restrictive business practices, when effective, will clearly affect firm behaviour. The firm will be forced to formulate its objectives on the assumption that conflicts with competitors and their customers and suppliers cannot be resolved by restrictive agreements. The firm must therefore formulate its objectives differently and employ different managerial policies to reach them in a situation where restrictive practices are not permitted. There was a general consensus that firms do obey the law, with obvious exceptions, and that decisions are effected where the law is present; the existence of a law itself was said to be a clear deterrent to restrictive business practices and to affect individual firm decisions.

But there is a difficulty, here, because officials and legislators approach the problem of controlling monopoly, dealing with monopoly and restrictive business practices from different standpoints. The legislator looks at the whole economy and makes his policy decisions in relation to it. The manager's approach is much more limited, because he is limited to the objectives and the policies of the single firm. The firm has difficulty, so we were told, in identifying what the public interest is in relation to its decision, and we were told that this is one of the difficulties in formulating a firm decision; that the firm is either not told what the objectives of the authorities are, in cases where the law was imprecise, or has too many public agencies to accommodate in reaching its conclusion. So we find that we have a problem with areas of uncertainty, or the grey areas as they are often called. They present an important problem we were told, in the firm's decision-making. This situation of uncertainty arises particularly where the law is drafted in broad general terms and where jurisprudence has not fully defined the limits of the law, or where in the law there is an element of judgment or discretion in particular situations. This obviously gives a different impact to restrictive practices laws in different national markets. For example, price fixing and other restrictive agreements or cartels are generally outlawed in most countries that we discussed or virtually so. In any case, a climate has developed that inhibits them, in addition to the law The firm will tend to avoid this technique and seek other policy alternatives, and this it seems is reasonably clear. It may not be so clear where rationalization and specialization agreements are permitted under conditions to be specified by a tribunal or put through gateways where the public interest must be satisfied as the basic test. Mergers or takeovers may be in the doubtful area in the United States for example, where percentage tests to the market which produce illegality are becoming exceedingly low (and there was some suggestion that if merger policy is pushed too far in this respect, it may cause distortions in the market) or in the United Kingdom where they are screened out by the Board of Trade and possibly referred to the Monopolies Commission. By contrast there is a greater certainty in Germany and the Common Market where mergers are not prohibited and the decisions of firms are not affected by the restrictive practices laws to the same extent except perhaps where the firm has achieved a market dominating position, in which case, we were told, it has to take a very careful look at its position.

The uncertainty of the law, or uncertainty of the outcome of proceedings or administrative decisions, and discretionary decisions, together with the time taken to complete the proceedings, seem to have given rise to several implications that came out of the discussion. The first is that this promotes a risk that must be weighed by management in making its decision, that is the risk that enforcement will follow or risk that a clearance to the plan will not be received or will not be received for many months or years dedepending upon the jurisdiction.

A second factor that arises is that the opportunity cost of proceedings once they are in progress can be very great. It was pointed out to us that senior executives of firms may spend a great deal of their time during the course of an important case which is being put through a tribunal or being fought in the criminal courts in, say, the United States, which opportunity represents a distinct opportunity cost to the firm.

There is a third problem, of what we might call the anti-trust 'overkill', which results from uncertainty in the law so that perhaps in the minds of the clients, perhaps in the opinion of the legal advisers, extends to a grey area on the periphery so that the advice will be, and the decision taken, not to make the move which seems the best business move to make because of the fear or the threat that either proceedings may follow or the plan may not be cleared through the tribunal. There was also some feeling that decisions may in this respect be transferred to lawyers and out of the hands of business men: that proposition was not actually agreed to by the whole group because the general feeling was that while some might hold that opinion the legal advice was simply one more factor to be weighed in making the decision.

An aspect of the delay or the length of time that it might take to get proceedings through the tribunals is that investment decisions, which it might be critical to make immediately, are delayed pending the outcome of the proceedings, when they are too lengthy and thus you have a distortion of that type in the situation of that kind. Of course, the length of time it takes to complete the proceedings differ in different jurisdictions. One final point that comes out of the uncertainty and time factors—in the United Kingdom it was said that an undertaking to the Restrictive Practices Court is in effect a perpetual injunction, which, in a subsequent environment, may cast doubt on new proposals that are made by the firm or being thought about by the firm, that could be construed as an arrangement giving rise to contempt, and this was thought to be a problem by some. Those who are knowledgeable about the operation of the Court and how the Orders of the Court, the undertakings given to the Court, will be applied, thought that this is after all something which the business firm must look to and must take its chances with, and obviously, being under

an Order of the Court, cannot really complain if it does not understand it, because it did after all give the undertaking.

Disincentives to expansion of market shares, [illegible] pression of view therefore resulted in the Committee for the following ideas.

Firstly, greater certainty in the law, but it was admitted that this would give rise to rigidity and it would be at the expense therefore of flexibility Some in the group preferred a state of uncertainty but the possibility of having some sort of pre-clearance of your proposal, in view of the uncertain state of the law or the general state of the law. The second idea that came out was that it would be helpful if greater speed in proceedings could be developed and it was suggested that there might be a pre-trial conference which would be a matter to be carefully worked out Pre-trial conference as I understood it would relate to what is called a merit case and it is a technique which has been employed elsewhere and we made no attempt whatever to work out the mechanics of it. The third point that emerged was that clarification of undertakings to the Restrictive Practices Court, which are in effect the perpetual injunction I mentioned, might help in new situations that develop or new environments. The real problem here—we had the benefit of a very practical suggestion made by one of our members which seemed to appeal at first to those present, but in view of technical difficulties of working out, the best I think that I could put forward as coming from the Committee, would be that some method of doing this might be worthy of study; certainly study of such a proposal would have the support of a good number of members in the Committee.

The Committee gave wholehearted approval to the Registrar of Restrictive Trading Agreements' policy of consultation on proposed agreements. This type of technique was regarded as extremely helpful in assisting the firm in making its individual decisions as to whether to carry an agreement forward and place it before the Court, or not to do so. It was also indicated that there is some merit in informal discussions with the authorities on proposed mergers or other possibly doubtful activities.

Now, what is the firm reaction to the ban on agreements? Very briefly this. The proposition was advanced that the combined impact of the law against restrictive agreements, the striking down of agreements and the climate of opinion against agreements has driven firms to merge as a substitute for agreements, especially where there is excess capacity or the market is declining. The opinion on this was divided. This proposition was not accepted at its face value and there was some strong disagreement expressed on the ground that other factors were more likely to account for takeovers, such as disciplinary measures in the market or the removal of a weak seller from the market, not the other suggestion that it is an alternative to agreements. In Germany the ban on cartels was said to have coincided with a greater tendency on the part of firms to go it alone. In other words I thought that the expression of opinion there indicated that it was not necessarily the anti-cartel laws that stopped firms agreeing that they were going to stop doing it anyway. I did not hear that exactly challenged but it seems to be contrary to experience elsewhere. The [illegible] individual firm decisions to do that. However, in the view of the German expert this might be expected to lead to greater concentration in the field of homogeneous products

Now, what about the effect of the restrictive practices laws on the strategy of the firm One expert opinion was expressed that the laws have no effect on [illegible] what motivates the firms, what its goals are, in which knowledge we are deficient An opposite opinion, perhaps more related than the first to the short-term, indicated that there is evidence available in the United Kingdom and in Europe that firms have failed to expand their markets for fear of enforcement of the law They have failed They have just not taken the step to expand their markets In other cases a firm has been known to help its competitors to avoid becoming a market-dominating enterprise. Keep them in business, then you're not a monopolist We were told of one newspaper that was spun off to reduce the market share of the parent. Also it was said that firms have been known to move to product differentiation, to replace price cartels or move out of the standardized product to specialized products as a reaction to the ban on resale price maintenance. We didn't get into this very much incidentally because of the work of Working Party No 5. However we should not, we were told by at least one expert, over-emphasize the effect of the laws on the behaviour of the firm where there is free access to the market. With freedom of entry, it is suggested, in Germany at least, competition is acute.

Now on the point about entry to the market, the consensus was that entry to European markets by buying-in, by joint ventures or takeovers is not inhibited by restrictive practices laws, but the case is quite different in the United States Here the anti-trust laws create uncertainty by reason of the strict merger control that we have spoken of, but the United States' opinion seemed to be that any new entrant with no existing foothold in the market is not excluded by the laws from buying-in. There is no problem about that, and yet there is some opinion, perhaps part of the anti-trust 'overkill' that I mentioned, that US laws do inhibit entry or expansion by takeovers and this distorts investment in international markets.

So far as I was able to determine from the sense of the meeting, and I am going to cut this short, the growth of the firm by internal growth is not inhibited by the anti-trust laws. Even in the United States we were told by the experts present that internal growth itself would not be inhibited but by merger a situation is different. We are told that the laws have acted as a deterrent by reason of the recent decisions that I have mentioned and that as a result you have this distortion

or re-direction, that in the United States firms are increasingly moving into conglomerates instead of horizontal and vertical ones which are denied to them. However there was no substantial feeling that growth was hindered, and one other important point emerged that expansion of the firm when prevented by US laws from taking place within the United States tended to re-direct itself in the acquisition of firms in foreign markets particularly Europe and the United Kingdom.

Now we did not see any great problem in the case of innovation. It was said that there should be no problem whatever, although there was some fear of it, about agreeing to do research, but the general feeling was, on the part of the legal experts, that indeed a genuine agreement merely to co-operate on research by itself and in the absence of other factors would not give rise to problems in the United Kingdom. It certainly would not in Canada, although we did not discuss the Canadian legislation, because the Chairman kept quiet about it and therefore we find that there may be a problem in the United States, but probably not in Europe.

Well, conclusions: not really a very strong conclusion. It was hard to draw them because while we had an excellent free-ranging discussion, and a great deal of exchange of information, we did not really attempt to reach conclusions, but the following I think might be said:

Restrictive business practices laws do have a strong impact on firm decisions, there is no question about that whatever, re-directing the firm's attention in other directions. Secondly, more research on motivation and firm goals and objectives is required. Thirdly, more attention is required to the methodology by which we find out about the behaviour of the firm, that is behaviour in the sense of how and why the individual decisions are made. More certainty in the law seemed to be a good objective in the opinion of many, but there is a countervailing point about the need to have some flexibility in some areas. Speedier proceedings, with the possibility, just for study, of pre-trial conference in merit cases, and the possibility of studying the feasibility of some form of relief with respect to the undertakings given to the Restrictive Practices Court. For obvious reasons for study only because there are problems connected with it.

It was suggested that it might be wise, or at least it might be mentioned, that while there is no solution suggested, the multiplicity of agencies to which businesses are responsible create some problems in decision-making. For obvious reasons one cannot make a recommendation about that except to say the point was made as a serious one. Finally, a very important point, which we did not have time to discuss, was made by Mr Leyland, that more attention should be given to policies which promote positive steps to increase competition, not to rely merely on the negative impact, so to speak, of the restrictive practices laws. We can offer no help on that at the moment but various ideas occurred to all experts present and this I thought was a point well worth considering coming from the Committee.

2.2 The constraints imposed by anti-trust

J W Markham

I The scope of the analysis

'The individual business firm has come more and more to experience the constraints of anti-trust in the daily conduct of its business. This has occurred as the law has been broadened to cover the conduct of firms other than the largest and more than just ordinary business practices.'[1]

This statement is a succinct assessment of the probable effects contemporary anti-trust policy has had *upon the individual business firm in the United* States It also properly emphasizes the strengthening of anti-trust policy which has taken place in the United States over the past two decades—and, as I shall indicate in more detail later, in much of the rest of the western world as well—both in the breadth and intensity of the constraints imposed upon the private firm.

The analysis developed in this essay is addressed to these constraints, their specific nature and their discernible effects on the decision-making processes of

policies of the business firm, there is a less discernible and less immediate effect that is possibly of greater long-run importance; namely, the incentives for freedom of action anti-monopoly policies provide *other* firms because they constrain firms. In fact, the most significant aspect of such policies has traditionally been identified as the freedom of enterprise they encourage. For example, anti-monopoly policies presumably encourage the entry of new firms into profitable lines of enterprise in part because such prospective entrants are free from the fear that entrenched firms may drive them from the market place through the use of unfair and anti-competitive practices Stated *somewhat differently, anti-monopoly policies en*courage reasonably unencumbered entry and exit and its attendant reallocation of resources, the drive for efficiency, product improvement, and other such socially beneficial activities because they provide for a system of incentives and an industrial environment substantially *different from those associated with* either unrestricted laissez-faire or compulsory (or highly permissive) cartel systems

Moreover, the effect anti-monopoly policies have on individual firms behaviour is not attributable entirely to these policies as isolated political forces, the interactions between anti-monopoly and other public policies also affect the behaviour of business firms I have argued elsewhere[2] that the *combined* effect of the United States anti-trust *and* patent policies may very well have induced a higher rate of innovational effort and technological progress in the private sector than could logically be attributed to the two policies if each were weighed separately The

innovational effort (research and development) as means for attaining the higher rates of return But when both policies act simultaneously upon the firm innovational effort becomes the only legal means for attaining monopolistic rewards, and we can logically conclude that in these circumstances innovational

combination of both, because they complement each other in this respect, probably induces a higher rate

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[1] Clark C Havighurst, 'Foreword', *Law and Contemporary Problems*, Vol. 30, No. 3 (Summer, 1965), p. 461.

[2] 'The Joint Effect of Antitrust and Patent Laws Upon Innova...

economic system for promoting technical progress.

increased their respective firms' innovational effort (R and D outlays) more than they otherwise would have.[4]

It is also very likely that anti-monopoly policies have interacted with other public policies, notably those concerned with taxation, foreign trade and economic stabilization, in ways that have significantly affected the business firm's decisions. These effects, however, are of a more conjectural nature and less susceptible to quantitative measurement than those directly and very nearly entirely traceable to anti-monopoly policies as such, and for these reasons lie outside the scope of the following analysis.

II Business behaviour and anti-monopoly policies in the United States

The effects of any policy must obviously be assessed in terms of what might have occurred in its absence. In the social sciences we cannot, like the physicist, re-run the experiment, isolating the effects of the variable under analysis; instead, we must rely on imperfect observations concerning what alternative circumstances would have yielded. In the world of private business firms there are some time-honoured observations on what it would be like in the absence of legal constraints on firm behaviour. Adam Smith observed nearly two hundred years ago that businessmen of the same trade rarely convened without turning convivial conversation into conspiracies against the public. History has now revealed that this was an empirical as well as an a priori observation, and one that does not appear to have lost its validity over the years.[5] Where cartels or agreements among competing firms are lawful, and at least occasionally where they are not, they are formed. Absent prohibitions on monopolization, monopoly tends to occur. The 1968 Annual Report of the Federal German Cartel Authority reported that in the 1930s there were more than 2,000 organized cartels in Germany; under the new legislation the number has declined to 200, none of which are preoccupied solely with the traditional cartel objectives of price fixing and output restrictions. In the United Kingdom over 2,000 price-fixing agreements were registered under the 1956 Restrictive Trade Practices Act: the Registrar of Restrictive Practices declared in his 1967 Report that 'the mass of price fixing agreements has been dismantled . . .'. It may very well be true that the spirit of competition runs high in contemporary industrial societies, but there is overwhelming factual evidence that this spirit is subordinate to the stronger commercial incentive to substitute monopoly and restrictive agreements for competition when the law permits it. The theoretical economic models offered as explanatory hypotheses for this behaviour are liberally scattered throughout the relevant literature, and have been assembled in abbreviated form by Professor L J Zimmerman in his book bearing the appropriately descriptive title *The Propensity to Monopolize*,[6] a less formal and more specialized version of the same hypothesis has appeared in a *Fortune* article 'The Urge to Merge'.[7] The business annals of all economies giving wide scope to the private firm provide abundant factual support of the major hypothesis; in the absence of legal constraints private firms would tend to substitute on a large scale the instruments of monopolization, cartels and restrictive agreements for arm's length inter-firm competition; in fact, the incentives to make this substitution are so strong that it often occurs in spite of the anti-monopoly policies making it unlawful.

In this broad sense, therefore it can be said that policies restraining monopolies, mergers and restrictive practices, when vigorously and effectively administered, affect the very fundamentals of firm behavior. Such legal restraints force the individual firm to formulate its objectives[8] on the assumption that the conflicts they encounter with those of its rivals, customers and suppliers canot be resolved through restrictive agreements that adversely affect competition. When the individual firm cannot avail itself of this means of conflict resolution, it formulates its objectives differently and it must use different managerial policies for attaining them.

One cannot predict precisely how firms will behave when denied the possibilities of co-operative resolution of conflicts in their independent objectives. In fact, the variety of possible behavioural patterns comprises that area of economic inquiry we refer to as oligopoly, an economic problem area characterized by as many predicted solutions as we have sets of assumptions.[9] In spite of the plethora, and hence the inconclusiveness, of oligopoly models, however, virtually all formal treatises of this subject develop logical support for the general conclusion that the co-operative solution more closely approximates the monopoly solution than do those solutions for oligopolies where the individual firms are prohibited from co-operating. The single possible exception to this generalization is the well-known Chamberlin 'conjectural interdependence' solution[10] where, under a stringent set of assumptions, the monopoly solution may result when each oligopolist *independently* seeks to

4 This proposition is extremely difficult to verify but available empirical data are generally consistent with it, *see* 'The Joint Effect of Antitrust and Patent Laws Upon Innovation', op. cit., pp. 294-5

5 For an account of the history of combinations in the United States *see* Arthur R Burns, *The Decline of Competition* (New York: McGraw-Hill Book Company, 1936).

6 Amsterdam: The North Holland Press, 1952.

7 William B Harris, 'The Urge to Merge', *Fortune*, November, 1954, pp. 102–6, 236, 240, 242.

8 There is much discussion in the economic literature over what the objectives of the contemporary large business firm actually are. Most analytical models of firm behaviour are built on the assumption that the firm attempts to maximize profits, which is generally refined to read maximize the discounted present value of the future stream of after tax net incomes. However, some have contended that as an empirical matter alternative assumptions may have greater validity; for example, Professor William J Baumol has argued that most firm behaviour is consistent with the objective of maximum sales (or market share) subject to a minimum profits constraint; see his *Business Behaviour, Value and Growth* (New York: MacMillan Co., 1959), especially pp. 45–84.

9 For a systematic exposition of oligopoly models *see* Martin Shubik, *Strategy and Market Structure* (New York: John Wiley and Sons, 1959); Jesse W Markham, 'Oligopoly', *International Encyclopedia of the Social Sciences* (New York: The MacMillan Co., 1968), pp. 283–90; and William Fellner, *Competition Among the Few* (New York: Knopf, 1949).

10 E H Chamberlin, *The Theory of Monopolistic Competition*, 5th ed. (Cambridge: Harvard University Press, 1946).

maximize its profits. However, since this solution rests on the assumption that the ...

dustries, of co-operative conflict resolutions forces them to seek somewhat different objectives and to seek them by entirely different means. The preponderance of economic theory argues persuasively that this denial is conducive to patterns of firm behaviour more closely akin to those associated with classical competitive models, with all the welfare implications that this implies.

I should like to turn now to the more specific and more measurable firm behavioural patterns associated with particular anti-monopoly policies. For obvious reasons the analysis of these patterns relies heavily on the laws and data pertaining to the United States Since the behavioural patterns are obviously shaped by the substantive content of the pertinent statutes and the vigour with which the statutes are administered, it may be helpful at the outset of the analysis to present a brief sketch of the United States legislation that controls monopoly, mergers and restrictive practices.[11]

The Sherman Act of 1890, the parent anti-trust statute, forbids monopolization by single firms as well as certain inter-firm arrangements such as contracts in restraint of trade and conspiracies to monopolize. The Clayton Act of 1914 makes unlawful, among other things, mergers that tend substantially to lessen competition or to create a monopoly, and price discrimination that has these same effects; the statute also prohibits tying sales and limits interlocking directorates ...

1950. A section of the Federal Trade Commission Act of ...

practices; rather, they require the seller to provide the buyer with reasonably accurate and adequate information on the product and terms of sale so that he may exercise more enlightened choice in the market place. Legislation designed to serve this purpose i[s] receiving increased attention in the United States [and] elsewhere, no doubt reflecting the consumer's inability to evaluate the relative utilities of goods a[nd] services against their relative costs, especially in t[he] case of highly complex products. It is also evident [that] such legislation conditions in important ways the effectiveness of competition and, accordingly, as a[n] integral part of ...

consumer better informed they are omitted from t[he] following analysis – not because they are unimpo[rtant] but because their broad objectives can scarcely b[e] controverted.

For somewhat different reasons I shall also forg[o] explicit analysis of the possible ways prohibitions [on] discriminatory pricing affect firm behaviour Thi[s is] obviously not because such prohibitions have unimportant effects but rather because opinion vari[es] widely on what these effects are. On the one hand [it] can be argued that prohibitions on discriminator[y] pricing deny firms already in possession of monop[oly] (or monopsony) power the use of one means of exploiting and increasing such power, on the other hand it is frequently argued, and persuasively, th[at] rigid prohibitions on price differences frustrate so[me] of the very beneficial price competition that woul[d] otherwise occur The particular anti-price-discrim[ina]tion law of the United States (The Robinson-Patr[man] Act) has been condemned by the last three comprehensive analyses of anti-trust policy as unduly proscriptive and as more protective of small busin[ess] than promotive of competition. Predictably, it is t[he] House of Representatives' Small Business Commi[ttee] that generally springs to the defence of the statute [and] marshals the attack on those who urge that the statute be revised. Obviously, a law that generate[s] much heated controversy cannot be entirely impo[rtant] but precisely how it affects firm behaviour, other t[han] require that all price differences be carefully scree[ned] is not entirely clear.

The central core of United States anti-trust pol[icy] is concerned with the activities that constitute the title of this conference – monopoly, mergers and restrictive practices. One of the most undisputed f[acts] pertaining to the United States contemporary eco[n]omic scene is that over the past two decades polic[y] toward these activities has been administered wit[h] enormously accelerated vigour. This acceleration [is] clearly visible in the statistics on total cases initiat[ed]. For the four-year period 1945–8, the annual aver[age] number of anti-trust cases initiated by the Department of Justice, the Federal Trade Commission a[nd] private parties totalled 196; for the twelve-year period, 1950–62, the annual average was 1 05[...] more than a five-fold increase over the preceding period. Comparable data for the five-year period j[ust] ended are not yet available, but every indication is [that] the trend in total cases initiated is continuing to ri[se]. The most recent communiques from the Departme[nt]

[11] A detailed description of the legislation of the United States as well as other countries may be found in *Guide to Legislation on Restrictive Business Practices*, published by the Organization for Economic Co-operation and Development, Paris, France. The *Guide* is kept up to date through the issuance of supplements.

[12] The legislation covering packaging and loans and credit charges are popularly referred to respectively as the 'Truth in Packaging' and 'Truth in Lending' Acts.

[13] See Jesse W Markham, 'The New Antitrust Policy and Th[e] Individual Business Firm', *Law and Contemporary Problems*, Vo[l.] XXX, No. 3 (Summer, 1965), p. 610.

Justice's Anti-trust Division announce unprecedented case loads; the volume of cases at the Federal Trade Commission trended downward for several years but increased in 1969; the National Industrial Conference Board[14] reports that the annual average number of new merger cases initiated has risen from eleven to about twenty-eight in the past two years; and initiations of private anti-trust cases have become increasingly familiar headlines in the daily press and, perhaps the best single indication of the accelerated effort, the budgets of both anti-trust agencies continue their upward spiral.

Much of the rising trend simply reflects the mounting volume of cases initiated under established anti-trust doctrines. For example, the impressive increase in the annual average Federal Trade Commission cases of from 100 to 600 reflects the larger volume of cases initiated against methods of unfair competition, deceptive trade practices and discriminatory pricing.[15] For the most part these cases confront the business community with no new types of constraints but rather seem to emphasize the potential threat of those under which it has always operated.

There are at least four new developments in anti-trust policy, however, that confront the individual business firm with substantially *different* constraints, both in kind and order of magnitude, than it heretofore confronted:

1 Legal prohibitions erected against horizontal and vertical mergers and acquisitions since 1950, including the Department of Justice and Federal Trade Commission Guidelines announced to the public in 1968, have made these extremely hazardous means of growth, especially for firms operating in markets already highly concentrated.
2 The Supreme Court *Procter & Gamble Company* decision[16] in 1967, the cases initiated in 1969 against such diversifying mergers as the International Telephone and Telegraph Corporation's acquisition of Canteen Corporation, Grinnell Corporation, and the Hartford Fire Insurance Company, and public announcements on the part of both anti-trust agencies that they plan to prosecute so-called conglomerate mergers with greater zeal in the future, all tend to render conglomerate mergers potentially as hazardous a means of firm growth in the future as horizontal and vertical mergers have already become.[17]
3 The traditional doctrine of conspiracy has been extended in scope and the waves of treble damage suits that now inevitably follow in the wake of a finding of conspiracy combine to make any semblance of interfirm agreements or understandings on pricing highly vulnerable and extremely costly.
4 The threat of dissolution, once dormant, is growing perceptibly. Former President Johnson's *Task Force Report* urges that where the high levels of concentration characteristic of many oligopolies show no signs of erosion under competitive pressures, the government should take positive steps to reduce such concentration.[18] President Nixon's *Task Force Report*[19] does not endorse this and other proposals for the dissolution of concentrated oligopolies, but it does urge that they be subjected to both unremitting scrutiny and more intensified use of laws prohibiting conspiracy when pricing in such industries is found to be anti-competitive.

These developments are generally recognized by students of United States anti-trust policy and scarcely require detailed documentation. The extent to which horizontal and vertical mergers of the modest scale once regarded as normal means of business growth have been rendered unlawful is indicated in the *Von's Grocery*[20] and *Brown Shoe*[21] decisions. In *Von's Grocery* the court found the merger of two local retail food chains having a combined market share of about 7 per cent in violation of the anti-merger statute. The recently announced Department of Justice *Guidelines* state that the Department will challenge horizontal mergers in highly concentrated industries involving market shares of the rough order of magnitude of 8 to 12 per cent. In *Brown Shoe* the court declared unlawful a vertical merger of a shoe manufacturer and a shoe retail chain, each with less than 5 per cent of its respective national market. The *Guidelines* state that the Justice Department will challenge vertical mergers between a seller accounting for as much as 10 per cent of the sales in its market and a buyer accounting for as much as 6 per cent of the total purchases in this market, and will challenge vertical mergers involving smaller market shares when there appear to be significant barriers to the entry of new firms.

The attack on conglomerate mergers is, as indicated above, in its incipiency, and consists more of announced intentions to prosecute such mergers than of actual cases.[22] But the direction and scope of the attack is becoming visible. In *Procter & Gamble* the nation's leading manufacturer of soaps, detergents and cleansers was found to have violated Clayton Act, Section 7, when it acquired the Clorox Chemical Company, the nation's largest manufacturer of household liquid bleach. In a similar 'product extension' merger General Foods Corporation's acquisition of the SOS Company, a large producer of household steel wool pads, was also found unlawful. The International Telephone and Telegraph Corporation was prevented from acquiring the American Broadcasting Company, one of the nation's three radio and television net-

14 Betty Bock, *Mergers and Markets: 7*, National Industrial Conference Board Studies in Business Economics, No. 105 (1969).
15 Cf., *Annual Report of the Federal Trade Commission*, 1967, Chapter 1.
16 386 US 568 (1967).
17 The emphasis here is on the potential illegality of conglomerate merger. Former President Johnson's *Task Force Report on Antitrust Policy* (July 5, 1968) noted that the individual firm was given considerable latitude in making conglomerate acquisitions, and President Nixon's *Report of the Task Force on Productivity and Competition* urged that this latitude not be substantially reduced until additional factual information, to be developed through public conferences, justified it.

18 Ibid., Chapter II.
19 Op. cit., p. 1.
20 *United States v. Von's Grocery Co.*, US 270, 274 (1966).
21 *Brown Shoe Co. v. United States*, 370 US 294–344 (1962).
22 Cf. Merger Statement Policy by the Assistant Attorney General for Antitrust before the House Ways and Means Committee, March 12, 1969, reprinted in *The Journal of Reprints for Antitrust Law and Economies*, Vol. I (Spring, 1969), pp. 201–14.

works, and the Government has challenged ITT's acquisition of Canteen Corporation and its proposed acquisition of Grinnell Corporation and the Hartford Fire Insurance Company. Similar cases have been [illegible]

acquiring firm is a 'potential entrant' to the acquired firm's industry; hence, the merger lessens potential competition; and (2) the merger enhances the prospects of reciprocity arrangements that circumvent the competitive forces of the market place

Recent decisions have enlarged and extended the traditional doctrine of conspiracy in several important respects. The Federal Trade Commission's decision in *Schenley Industries Incorporated*[23] and the Supreme Court's ruling in *Perma Life Mufflers, Incorporated* v. *International Parts Corporation*[24] have greatly extended the Sherman Act's per se prohibition of agreements in restraint of trade to intracorporate activities—a parent corporation can be found to have conspired with itself in the form of one of its subsidiaries The Court's 1969 decision in *United States* v. *Container Corporation of America*[25] expanded the doctrine of conspiracy to include the practice of furnishing one's rivals with information on current prices when rivals [illegible]

jury to use 'unusually high' prices and profits substantially 'in excess of normal levels' as evidence that a price conspiracy was in effect.

What appear to be the changes in business behaviour directly attributable to this impressive array of newly fashioned anti-trust constraints? What discernible evidence is there that the atmosphere so heavily ladened with the elements of the newly invigorated anti-trust policy has altered the conduct of business firms subject to its jurisdiction?

Answers to such questions hang in large measure on the methodological approach one uses, of which at least three come readily to mind:

1 Direct observation of business executives, carefully noting the specific weight they assign to prevailing anti-trust doctrines as they make decisions on such matters as pricing, market penetration, internal growth and acquisition.
2 Indirect observation of the effects of anti-trust doctrines on firm decisions by seeking the relevant information though interrogation of business executives
3 Inferring what these effects are from whatever pertinent quantitative data as may exist.

While there is much to be said in favour of methods (1) and (2) on purely scientific grounds, the practicalities of the situation dictated heavy reliance on method (3).

Contrary to what one might logically adduce from the constraints on business mergers the recent decisions appear to erect, it is obvious that they have not brought about an absolute reduction in the volume of *industrial mergers in the United States* The most recently released data by the Federal Trade Commission show that in 1968 the total number of manufacturing and mining concerns acquired reached the unprecedented number of 2,442, and total acquisitions of all kinds exceeded 4,000 (Table I). Again, contrary

Table I

Total acquisitions and acquired assets[a] compared with new investment[b] in manufacturing and mining, 1948–1968

Year	*Total concerns acquired*	*New investment*	*Acquired assets*	*Acquired assets as per cent of new investment*
		(*Billions of dollars*)		
1948	223	10·01	0·130	1 3
1949	126	7·94	0·067	0·8
1950	219	8 20	0·173	2 1
1951	235	11 78	0·201	1 7
1952	288	12 61	0 327	2·6
1953	295	12·90	0·679	5 3
1954	387	12·02	1 425	11·9
1955	683	12 40	2 129	17 2
1956	673	16·19	2·037	12 6
1957	585	17 20	1 472	8·6
1958	589	12 37	1 107	8·9
1959	835	13 06	1·960	15·0
1960	844	15 47	1 710	11 1
1961	954	14 66	2 129	14 5
1962	853	15 76	2 194	13·9
1963	861	16 73	2 917	17 4
1964	854	19 77	2 798	14 2
1965	1,008	23 75	3·900	16 4
1966	995	28 46	4 100	14 4
1967	1,496	28 11	8 222	29·2
1968[c]	2,442	28 27	12·616	44·6

[a] Acquisitions of manufacturing and mining firms with assets of $10 million or more.
[b] Total expenditure for new plant and equipment by manufactur[illegible]

to what one would expect in view of the new and more stringent legal constraints on merger, this has become an increasingly important means of growth of the individual firm in manufacturing and mining with assets of $10 million or more. Between 1960 and 1968 the ratio of assets acquired through merger to internally generated new investment in plant and equipment rose from about 15 per cent to 44 6 per cent. It [illegible]

mergers', but if this is borne out by the 1969 merger data when they become available to the public it will represent a sharp reversal in the trend over the past decade.

It is not to be concluded from this that the more [illegible]

legal constraints been much weaker or non-existent

[23] *Trade Reg Rep* paragraph 17,353 (FTC, 1965)
[24] 392 US 134 (1968).
[25] *Trade Cases*, paragraph 72,673 (S Ct. 1969)
[26] *United States* v. *Charles Pfizer & Co*, Inc, 281 F. Supp. 837 (SDNY, 1968)

[27] *The New York Times*, Business and Financial Section, June 29, 1969, p. 1.

is of course a matter of speculation, but it is known that many large firms have laid aside their merger plans because of the high probability that the contemplated merger would be declared unlawful if challenged. For example, only one of the top ten corporations on *Fortune*'s 1968 list of largest industrial corporations has made an acquisition of $10 million or more since 1964, and this was a single product extension acquisition.[28] Only five of the top forty have acquired firms with assets equal to or greater than $10 million since 1966. In the past several years merger and acquisition activity among the very large firms has been concentrated almost entirely in the large conglomerates and petroleum companies. A reasonable inference is that the restraint exercised by the remaining giants of industry reflects the more intensified attack on mergers, especially horizontal and vertical mergers.

Whatever may have been the impact of the more vigorous and restraining merger policy on the total volume of mergers, it is clear that this policy has significantly affected the *types* of mergers and acquisitions business firms consummate. As the data in Table II clearly bear out, in mergers involving acquiring firms of $10 million or more there has been a dramatic shift away from horizontal and vertical acquisitions and toward conglomerate acquisitions. In 1948–51, the four-year period immediately preceding the birth of the more constraining merger policy, horizontal mergers accounted for 41 per cent of total acquired assets in large mergers and, together with vertical mergers, accounted for 62 per cent. Since 1951 the trend in horizontal and vertical mergers has been sharply downward while the trend in conglomerate mergers has turned upward to where the latter have become the dominant form of acquisition. In 1968 conglomerate mergers accounted for 84 per cent of the total number of large mergers and for 89 per cent of the total assets acquired through large mergers.

While financial and business analysts attribute a part of the sharp upward trend in conglomerate mergers to the emphasis large corporations place on diversification in their plans for growth, much of the trend is unquestionably attributable to the differences in legal status of various types of merger under the more intensified merger policy: the constraints on large horizontal and vertical merger have been greatly strengthened since 1950, therefore firms have tended to grow relatively less through horizontal and vertical merger; on the other hand, at least until very recently, the probability that large conglomerate mergers would be successfully prosecuted was minimal, therefore firms have increasingly relied on this form of acquisition as a means of growth. The frequency with which the very large companies engaged in the three types of merger is especially revealing since their merger activities presumably come under unusually close scrutiny by the anti-trust authorities. In the two years—1967 and 1968—the largest 100 industrial corporations made a total of only four large ($10 million or more), horizontal acquisitions, but they made a total of fortyseven large conglomerate acquisitions.

The more stringent merger policy appears also to have produced an interesting shift in the relative importance of sub-types of conglomerate mergers consummated. Product-extension and market-extension conglomerate acquisitions bear a somewhat closer kinship to horizontal merger than do acquisitions of totally different and unrelated facilities. Because they often represent either the acquisition of a related product (such as Procter & Gamble's acquisition of Clorox) or facilities for producing the same product in a different geographical area, the legal constraints on horizontal merger can, with appropriate modification, be applied to such acquisitions. But these constraints are not especially pertinent to acquisitions of totally different and unrelated production facilities, such as an electronics manufacturer's acquisition of a book-publishing company or a bread baking company. In recent years there has been a discernible increase in the latter type of conglomerate acquisition relative to product- and market-extension conglomerates. In 1964 highly diversified and unrelated conglomerate acquisitions accounted for only 3 per cent of total assets involved in large acquisitions of all kinds, whereas in 1968 they accounted for 43 per cent. A plausible explanation, and one emphasized by former Assistant Attorney General Donald F. Turner while he headed up the Department of Justice's Anti-trust Division, is that the newly developed legal constraints on merger were not readily applicable to strictly conglomerate acquisitions of this type.

Table II

Distribution of total number of mergers and of total acquired assets in large[a] mergers, by type, 1948–1968[b]

Type of acquisition	*1948–51 (Per cent)*	*1952–5*	*1956–9*	*1960–3*	*1964 Per cent No.*	*assets*	*1965 Per cent No.*	*assets*	*1966 Per cent No.*	*assets*	*1967 Per cent No.*	*assets*	*1968 Per cent No.*	*assets*
Horizontal	41·4	36·5	27·2	12·6	14	13	14	9	13	8	7	13	7	4
Vertical	20·5	11·5	20·1	24·7	18	22	12	6	13	10	10	6	9	7
Conglomerate	38·1	52·0	52·6	62·6	68	64	74	85	74	82	83	81	84	89
Product extension	38·1	45·7	33·5	37·7	62	59	47	41	50	36	61	58	59	39
Market extension	—	2·7	4·9	8·0	3	2	6	22	2	18	0	0	1	6
Other conglomerate	—	3·6	14·2	17·0	3	3	20	22	23	28	22	24	24	43
TOTAL	100·0	100·0	100·0[c]	100·0[c]	100	100[a]	100[a]	100	100[a]	100	100	100[a]	100	100[a]

[a] Firms with assets of $10 million or more. Detail does not add to total due to rounding.
[b] Figures for 1968 are preliminary; 1948–63 data for assets only.
[c] Detail does not add to 100·0 per cent due to rounding.
Source: Bureau of Economics, Federal Trade Commission.

28 *Federal Trade Commission, Large Mergers in Manufacturing and Mining, 1948–1968* (April, 1969).

Finally, the stricter United States merger policy has apparently had the conse[illegible]

[illegible] the sharp increase in foreign subsidiaries of large multinational corporations established in the 1958–67 period (Table III), and especially the sharp increase in overseas acquisitions in this period, suggests that the growing severity of constraints on acquisitions at home may have been an important factor [29]

Table III

Subsidiaries established abroad by 187 large multinational corporations, by type, 1946–1957 and 1958–1967

	1946–57		*1958–67*	
	New investment	*Acquired*	*New investment*	*Acquired*
Outside United States				
Total	1,082	635	2,557	2,442
Canada	159	187	144	370
Latin America	418	157	642	477
Europe—EFTA	124	88	419	430
—EEC	139	90	593	656
—Other	34	16	123	107
Japan	18	17	121	53
All other	190	80	515	349

Source The multinational research project, Graduate School of Business Administration, Harvard University

The foregoing analysis rests largely on the discernible trends in merger data that appear to be closely related to change[illegible]

[illegible] and of such recent origin

It is clear, however, that an attack on conglomerate mergers, both under existing statutes and in terms of explorations into the possible enactment of new legislation, has begun. The Justice Department has initiated cases against conglomerate acquisitions of Ling-Temko-Vought, Gulf and Western Industries, Litton Industries, and the International Telephone and Telegraph Company Attorney General Mitchell and his Assistant Attorney General for Anti-trust Richard McLaren have repeatedly stated publicly that they plan to arrest the current conglomerate merger movement. The House Committee on the Judiciary has begun to hold hearings on conglomerate mergers, looking to possible new and more effective legislation. The Federal Trade Commission is conducting a study in depth of the eight most prominent conglomerate firms. The implications this mounting attack on conglomerate mergers holds for the large corporation are of obvious significance [illegible]

While this policy development would reduce the rate and alter the form of [illegible]

[illegible] middle-size corporation as the principal participants in merger activity.

Meanwhile [illegible]

[illegible] electrical equipment price conspiracy cases of the early 1960s has proceeded at an unprecedented pace, and there is no particular reason, economic or political, why it will, or should, subside Even the most hostile critics of anti-trust policy in the United States favour the vigorous prosecution of price fixing arrangements. Increasingly, private parties and public agencies other than the Department of Justice are bringing [illegible]

[illegible] States—once regarded as a sporting venture—has become an excruciatingly painful and costly experience.[30]

Whether the more serious consideration given dissolution in recent years will in fact lead to

[29] The United States Anti-merger laws have been invoked against foreign acquisitions, but only on very few occasions.

[30] The mounting costliness of price fixing is [illegible] Department of Justice has recently proposed maximum fine be increased from the present

of this remedy is a proposition on which we can only speculate. The arguments for dissolution in the most extreme cases of persistently high concentration on a selective basis are very persuasive. If as a matter of public policy mergers involving 10 per cent or less of a relevant market are prohibited, it logically follows that important industries should not be left exclusively in the hands of several firms, one of which may have 50 per cent or more of the market. Moreover, since the anti-competitive price patterns that customarily emerge are not usually born of conspiracy they cannot be successfully attacked as restrictive agreements. These arguments have of course been made before, with equal conviction and equally as persuasive. All that can be said at this stage is that anti-trust practitioners and students of the monopoly problem, and hence the large firm in possession of substantial market power, are now taking them more seriously.

III Anti-monopoly policies in Europe

For very practical reasons I must deal in much broader terms with the issue of firm behaviour in regard to European policies on monopoly, mergers and restrictive practices. In the matter of monopoly, i.e., single firms with substantial market power, and restrictive practices much of what has been said in the foregoing analysis of the situation in the United States pertains also to most of Europe. While the legislation and administrative procedures differ considerably, agreements that clearly impair the functioning of competition in the market place are, as matters of national and supra-national policy, unlawful. In the EEC the Commission's announced policy on cartel agreements is that they '*in general* are unlawful'.[31] In the United States they are per se illegal. And in the United Kingdom they are unlawful unless parties to the agreement can demonstrate them to be in the public interest. The language is no doubt more uniform than are the respective policies in practice but, in general, business firms in all these jurisdictions enter into such restrictive arrangements as price fixing agreements with the risk of violating public law. To be sure, the risk probabilities and the severity of penalties vary.

Similarly, the impact of monopoly policies on dominant firms with substantial market power bear reasonably close similarity as between much of Europe and the United States. While the prospects and possibilities of its dissolution in the United States may be greater, as a practical matter dominant firms in Europe and the United States are controlled much more through ad hoc political and economic pressures than through the harsher remedies and penalties associated with effective anti-monopoly laws. When the United States Steel Corporation, General Motors, or one of our major pharmaceutical companies initiates an inopportune price increase, the regulatory remedy is not, at least not yet, dissolution of the market power making the price increase possible, but rather an admonition from the White House or the Chairman of the Senate Committee on the Judiciary that the price increase should be rescinded. The admonition is of course more effective if the firm happens to have substantial business with the Department of Defense. This ad hoc approach, combined with the instrument of public exposure, is not at great variance from dominant firm regulation in much of Europe.

Where the business firm in Europe confronts a policy entirely different from that of its United States counterpart is in respect to mergers. This essay has already made reference to Mr Harris' *Fortune* article, 'The Urge to Merge.' It perhaps needs now to be added that the urge resides in the private firm, and the mounting formidable means of controlling it reside in the anti-trust agencies and the courts. In Europe there is also an urge to merge, but much of the urging is coming from the government—and J-J Servan-Schreiber.[32] The EEC Commission has made it official policy to encourage 'rational' mergers and has explained in its 1965 memorandum on Concentration of Enterprises that 'increased concentration of European firms in the Common Market was desirable'.[33] In the United Kingdom there is also a similar widely held view that: 'In the case of monopolies and mergers there is no presumption in the law that market power works against the public interest.'[34] However, in the United Kingdom some mergers are challenged and the Monopolies Commission has found a few to be against the public interest.[35] Also the EEC has stated that mergers by dominant firms may be challenged under Article 86. But with these few potential obstructions the firm in Europe, in sharp contrast with the United States firm, is not only relatively free to merge but is encouraged to do so.

IV Postlude

In this essay I have attempted to relate the more visible manifestations of laws concerning monopoly, merger and restrictive practices to the business firm. Of necessity, the visible manifestations are limited largely to statistics on business events such as merger and court cases. But while the analysis must centre on such publicized and quantifiable events, it should be emphasized that the meaningful consequences of such public policies may, like the iceberg, remain below the visible horizon. Such laws operate much more through the advice a corporation president receives from legal council than through court decrees although the two are obviously inter-related. In large measure therefore our analysis must be based on events precipitated by mistaken views of what the laws really mean.

In addition to those based on the visible manifestations of such laws there are of course the conclusions that flow from a priori reason. In general, monopoly and restrictive practices policies severely proscribe the substitution of collective for individual

31 Grant W Kelleher, 'The Common Market Antitrust [illegible] The First Ten Years', *The Antitrust Bulletin*, Winter [illegible], p. 1231, italics in original.

32 See J-J *Le Défi Américain*, Also the English translation, *The American Challenge* (New York: Atheneum, [illegible]).

33 Cf. Keller, op. cit., p. 1231.

34 Mr Anthony Crosland, President of the Board of Trade, quoted in '[illegible] Restrictive Trade Practices [illegible]' [illegible] Fall, 19[illegible]

35 Ibid. [illegible]

action in the market place and limit the possession and/or the abuse of undue market power. Hence, most of the effects of these policies are felt in the business atmosphere they create and nurture. As the famous British economist John Hicks has observed, the main reward of the monopolist is the 'quiet life' he enjoys. But corporate somnolence is not often socially and economically highly productive. We have no instruments for measuring either these atmospheric conditions or durations of sleep. We are relatively sure, however, that in the absence of anti-monopoly policies the atmosphere would be decidedly more conducive to unproductive business slumber.

2.3 Monopoly control from the point of view of the firm

N H Leyland

Introduction

One of the most difficult problems that arises in looking at monopoly control from the point of view of the firm is that we have no tested theory about the firm's growth. We have many theories about growth at the macro level and few would dispute the usual determinants of that growth even though they would dispute the weighting of the various contributory elements. To some extent the doubts which have arisen about the usefulness of growth theory for policy measures to stimulate growth should be attributed to the failure to understand the processes by which firms react to changes in the environment and the lags in that reaction.[1]

The lack of a theory of growth is nowhere better illustrated than in the teaching of micro-economics. The emphasis here is invariably on static models which are used to determine the properties of allocative efficiency. Even within the assumptions of the models, grave doubts have been thrown on their usefulness.[2] The assumptions themselves are unrealistic and static. And yet a whole range of welfare conclusions derived from simple models have been taken over implicitly into judgements about the public welfare.

We do not have any discussion about the extent to which, in the fashionable phrase, allocative efficiency should be traded against growth.[3] It might be argued that there has been no such discussion because there is no antipathy between these two desirable objectives. But I suspect that the real reason lies in an ignorance of the process of growth at the micro level and the difficulty of quantifying the effect of disequilibrium on growth rates. There are however some inherently plausible arguments which may be used. All long-term increases in output per head come from c
in technique, whether these are reflected in ch
the product, in the production process or in bo
together. Growth proceeds through a series of
equilibrating forces which are continually at v
At any moment in time it would be possible to
the output of particular commodities by comp
firms making above average profits to cut pric
because the advantage they have achieved in p
or process already exists. A once for all short-te
could therefore be achieved but this may be do
more than improve short-term allocative effici
the expense of long-term. What, however, wou
the effect of doing this systematically? If it were
in advance that profits generated from innovat
would be squeezed by administrative act, what
would that have on the rate of innovation? We
know. But it is very hard to believe that it woul
no effect. What matters in this connection is no
the process of invention, or innovation, but the
which they are effectively diffused through the
It is likely that if the expected rate of return we
reduced product life cycles would lengthen. Thi
arise from entirely rational behaviour on the pa
the businessman.

Consider for example the case of an oligopoli
market in which prices have been stable and sh
the market have changed very little. One of the
devises a product improvement which would en
it to enlarge its market share, establish dominan
(perhaps only temporarily) and increase its rate
profit. Such action is of course risky as it will dis
the price equilibrium, but the expected rate of p
justifies the acceptance of the risk. If we now ad
expectation that the new state will be examined
a Government agency with a finite chance of pr
to reduce the new price level, on the grounds tha
excess profit is being earned, then, either the imp
ment will not be exploited, or it will be introduc
more slowly so as to disturb the market less. In ei
case the life cycle of the products being produced
been lengthened.[5] I shall argue that there is no co
herent model of competition to which business m
refer either to defend itself when called to accoun

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1 The switch to investment grants from investment allowances affords a very good example of this. A measure which in principle should have been welcomed by firms was on the whole treated with great hostility.

2 See for example G B Richardson *Information and Investment* which demonstrates that in the hypothetical system of perfect competition firms would be unable to undertake the informed investment decisions necessary to bring about the efficient adaptation of supply to demand.

3 We have little discussion on the value of variety. There may well be a trade-off between variety and allocative efficiency. But it would not be a simple matter to determine which way the balance would lie. Greater variety and therefore greater possibility of choice is a positive economic good.

4 Innovation may either be in the productive process or the product, or both. From the point of view of the argument it immaterial.

5 *See* N H Leyland, 'Competition and Growth', *Oxford Econ Papers*, March 1964.

by which it may act to avoid such calling. The theory is in a muddle and the implicit models which emerge from the activities of the Monopolies Commission, the Restrictive Practices Court and the agencies concerned with mergers are at best obscure, at worst inconsistent

The Monopolies Commission

It is very difficult indeed to infer a model of the competitive process from the Monopolies Commission reports. The Commission is the extreme example of a [illegible] inevitable, and may indeed, not even matter. But a close study of the reports will not reveal a set of preferences for one type of behaviour as compared to another. To some extent this may be the result of changing personalities both on the Commission and at the Board of Trade. There is now mercifully somewhat less emphasis on history and the reports appear a little more quickly.

I have suggested elsewhere[7] a set of tests which should be applied in monopoly investigations. These tests, though differently presented, appear in the guide to Board of Trade practice on mergers. The tests ask the questions: what is important is the [illegible]

I would suggest that the factor which the Commission regards as most important is the rate of profit.[8] *Whilst the effect of all other factors is finally* reflected in profits, it is on the 'rightness' of the profit rate that the Commission mainly bases its conclusions. Unfortunately it is very difficult to discover what the Commission regards as the right rate of profit for any [illegible] procedure provided four allowances are made:

- (i) for the relative riskiness[9] of the business;
- (ii) for the difference in growth rates between the reference output and the industrial average;
- (iii) for the place in the product cycle of the good concerned; and
- (iv) for the superiority of the management.

As to (i) while companies have on occasion argued that their activities were subject to above average risk (e g Molins in the case of cigarette machinery), [illegible] changing demands and changing production techniques there will be an array of products with different profit characteristics In the case of new breakthroughs it should be expected that the profit rate attributed to any particular product will be significantly greater than the average profit of the firm as a whole. This will not persist. It provides both a strong incentive to other firms to try to break down the advantage and to the firm in question the means to develop further products or processes. The important question here is what is the time span over which this superior profit rate can be expected to last? To preserve the incentive effect over what time span should it be acceptable? There is some evidence[11] that the relevant part of the product life cycle can be determined but the length clearly varies with the commodity or process, and with the degree of patent or other protection. The Commission has been in some difficulty in its analysis of the single product reference when the product is produced by a multi-product firm. In the case of colour film it condemned the high rate of profit and did not consider the rate of profit on the business as a whole to be relevant In the case of flat glass it did consider the relevant rate of profit to be that on the business as a whole The degree of *'monopolization' in the two products does not seem* to be significantly different. The high rate of profit on the reference products was regarded by both firms as the reward for successful innovation and equally by both firms as properly earned because high rates should be made on successful products. As to (iv), I must confess that only subjective judgements are possible. Some work has been done on attempting to [illegible] not explicitly stated.

The Restrictive Practices Court

The Court will probably now find itself in decline. There can be few agreements left to be tested. This arises mainly because the early judgements were fiercer than expected, but also because an appearance before the Court is very time-consuming and

[6] For the general principles to which regard should be paid see Monopolies and Restrictive Practices (Inquiry and Control) Act 1948. No modification was made in the Monopolies and Mergers Act 1965.

[7] 'Competition in the Court', *Oxford Economic Papers*, November 1963. They are based on work by Edward S Mason and consist of a set of questions in the following areas: profits; cost price rela- [illegible]

[9] Riskiness is here defined as the fluctuations in profit over time and is usually measured by the variance.

[10] There is some evidence of a change in emphasis in the latest reports. The Monopolies Commission does of course examine many other aspects. My concern is to see if there is one common element in their thinking

[11] E.g. in the pharmaceutical industry

expensive.[12] It is probably fair to say that, on the basis of the precedents, none of the traditional type monopolistic practices (e.g. price agreements, discriminatory pricing) are likely to get through the Court unscathed. Even if there could be attached to the agreement some unique advantage (e.g. encouraging research) there would, in advance, appear to be only a small probability of success. For this reason it is likely that new agreements which appear highly desirable to the firm involved, will try to get through the side door provided by the 1968 Act.[13] The general effect of the Court's judgements has been to help create a climate of opinion hostile to agreements. The practice of resale price maintenance, already undermined by changes in the structure of retail trade, is to all intents and purposes finished. One area in which we can expect increased activity is in the examination of information agreements. My guess is that relatively few will reach the Court.

The Court's activities have added to the pressures for concentration by merger or takeover. This does not imply any direct causal connection between the determination of, say, a price agreement and subsequent merger activity. Concentration may well have happened anyway. But there can be no doubt that in industries with serious long-run excess capacity and a number of weak sellers (e.g. yarn spinning) the price agreement would be a support to the structure of the industry.

Mergers

Over the last two years there has undoubtedly been a quickening in the concentration of firms. It is widely held that there is now a record number of small and medium companies willing and indeed waiting to be taken over. I believe there are two factors at work whose importance has been greatly increased by recent legislation and economic conditions and which have to be added to the forces which one might expect to be at work continuously.

First, insufficient attention has been paid to the effects of the 1965 Finance Act. The invention for tax purposes of the close company and the extremely restrictive and penal clauses in the Act referring to them made the financial position of a large number of small and medium sized firms at the very least uncertain. While the sillier faults of the 1965 Act have been remedied by the 1969 Act, there have been four years of doubt and uncertainty for a large number of companies.[14] The supply of companies willing if not anxious to be taken over was increased almost overnight. Moreover the effect of corporation tax was to reduce the liquidity of those firms which wished to maintain distributions at the previous level. To this squeeze on liquidity was added the interest-free loan to the government arising from SET payments and more recently very high interest rates combined with credit stringency. The full working out of these forces has not yet been seen.

The supply of companies for mergers was thus greatly increased by a combination of tax and credit uncertainties. The demand from companies anxious to expand was probably stimulated by the fact that it appeared cheaper and easier to obtain capacity or new profit possibilities by takeover than by new investment. Rights issues of equity appeared expensive and the market's capacity to absorb fixed interest issues was quickly strained. Moreover increasing size brings two benefits in the financial field. There are genuine scale economies of finance and larger size confers considerable bargaining power in tight credit conditions.

The Government recognized the dangers in opposing this movement and indeed, in the belief that on the whole British plants were too small for an international market, gave encouragement to concentration by setting up the IRC. Simultaneously it took powers to refer mergers to the Monopolies Commission. Business could be forgiven if, over the last few years, it has detected a certain ambivalence of approach to the competitive process. It is perhaps inevitable that when both opinions and the legislative process are in an evolutionary state in any particular area there should be both great uncertainty and an appearance of ambivalence. In an attempt to remove this ambivalence, the Board of Trade has published a set of questions which presumably the Board will answer in determining references and the Commission will have in mind in judging the desirability of the proposed merger.

I have examined these for clues as to the line the Board may be expected to adopt. It was essential to publish something to indicate the lines of thought of the Board, for the decisions on merger cases of the Monopolies Commission displayed no clear line of reasoning. The relevant headings for 'horizontal' mergers are set out and various questions which 'may arise' are given. These questions are most exhaustive and cover just about all the points that could arise. The headings are as follows:

(i) General considerations—these are concerned with the effect of mergers on competition and consist in the weighting of the benefits of scale and rationalization against possible diminution of competition. No presumption as to which way the balance lies is given;

(ii) Market power—horizontal mergers may either increase or diminish the degree of competition in the market but it is just possible to discern a slight presumption that diminution is more likely than increase;

(iii) Efficiency—there is in this section a definite presumption that mergers may be good for efficiency and that the realization of the full benefits will depend on the quality of management. There is also an admission that since mergers only create an opportunity to derive efficiency benefits, it will be necessary to make a subjective evaluation of

12 It is also expensive and time-consuming to appear before the Monopolies Commission, but this is not a matter in which the firm has a choice. Not the least expense is the opportunity cost of senior executives' time.

13 The Restrictive Trade Practices Act 1968 allows the Board of Trade to exempt agreements if the participants can establish that the agreement is necessary to promote some object of national importance (e.g. agreements about capacity extensions).

14 The marginal and average rate of tax for the close company could be as high as 75 per cent.

the quality of management in the proposed group;

(iv) Balance of payments—it is difficult to see from this section what expectation about effects on the balance of payments the Board has;

(v) Regional policy—there is here a clear lead that mergers which appear to conflict with regional policy would be referred.

Additional points are made with respect to vertical and conglomerate mergers. It is the latter which give the most trouble (as in a way they do in the US).

Conglomerates

[illegible] in which the benefits of good management can be diffused through new industries. There is both in this part and in the observations of the Monopolies Commission appended to the Reports on the Unilever/Allied Breweries merger and on the De La Rue/Rank merger, a somewhat curious presumption that conglomerate mergers may take place for purely 'financial' reasons and that these are therefore bad. This needs examination.

The purest case of financial motivation would be when a company takes over another for the purpose of acquiring assets which it buys cheaply and then sells at a profit. Quite apart from the fact that such a transaction would be heavily taxed, it is far from certain that harm is done to the economic use of resources by this action. If the assets were bought cheaply they must have been under-used. Probably the nearest approach to purely financial transactions were those that occurred in the property boom. It is very hard to see what harm was done to the nation's resources apart perhaps from the 'capricious' generation of a few large fortunes.

The more sophisticated variants of the financial argument run along the following lines. Firm A which has a high market rating takes over Firm B which because of its profit record has a poor one. Firm A may use cash or a mixture of cash and paper. It appears to buy a profit stream cheaply. There the argument normally rests. But this will not do. Firms which acquire poor profit earners and do nothing about them lose their own rating.[13] If firms were content with this situation it would imply a very peculiar management [illegible] largely financial reasons is that the initiating firm has to improve the performance of the firms taken over.[14] Conglomerates with high p/e's only retain their rating on performance. Their ability to buy earnings apparently 'cheaply' depends on a proven performance in improving the rate of return on assets. Not all conglomerates have high p/e's. Indeed a weighted average of a sample of conglomerates gives a p/e of 13·8 against a market average of 15·6.[17] Only very successful conglomerates (of which in this country there are only three or four) can operate in the way of the theoretical example, and woe betide them if they allow either earnings or earnings per share to fall.

Pragmatism

The British approach to monopoly problems has been pragmatic, determinedly so. Each case will be judged on its 'merits'. Even in the Restrictive Practices Court where agreements were stated in the Act to be against the public interest unless shown to be otherwise, the exempting clauses and the judgements left some scope for the 'merits' of the case.

The danger inherent in this approach is that when the decisions are left to a small group of people their views of the merits of the case may well crystallize into a set of rules whose logic or relevance are questionable. Alternatively their decisions may have about them an appearance of randomness or inconsistency. We have not reached this point but it cannot be far away. At the moment on the basis of decisions about mergers it is difficult to see any rules, but there are some dangerous currents visible in the thinking of the Commission and possibly in the Board of Trade.

The merits of the case where mergers are concerned must include an assessment of the gains from a change in managerial activity. The only certain guide, and that an imperfect one, is past performance. The argument used in the De La Rue/Rank reference that, on the basis of a poll conducted by the defending company so many senior executives would leave that efficiency would be damaged, must be completely unacceptable. It offends all the rules about attitude surveys and is not evidence at all. Yet it seems to have been very influential in the decision. Will defending companies in future contested mergers, always be preserved if they can produce similar 'evidence'? In the general merger case, and I am not suggesting that this was true in the De La Rue/Rank case, managerial changes are inevitable, or the benefits of the merger will not be released.

The other view that has emerged is that the Monopolies Commission is a better judge than the market of efficiency. It argues this on two grounds.

[13] This is what is wrong with the Monopolies Commission's hypothetical example on page 40. *Unilever Limited and Allied Breweries Limited. A report on the proposed merger and general observations on mergers*, HMSO, 1969. It is not carried on. What would happen to the market rating (an initial 50 : 1 p/e ratio) if earnings did fall 20 per cent even though earnings per share would have apparently risen? What is needed is that these 'purely financial' considerations should be spelt out with real examples. I suspect that they are largely mythical.

[14] Research on ten American conglomerates by A M Louis, *Fortune*, May 1969, shows that over a ten-year period earnings per share were not 'artificially' boosted by buying earnings in companies whose p/e was lower than their own.

[17] Conglomerates used were BET, Charterhouse Group, Cope Allman, Firth Cleveland, Grampian, Lindustries, London & Northern, Melbray Group, Norcros, Sears Holdings, Slater Walker, Thomas Tilling, Tube Investments, Vickers, John Wallace, Wiles Group, Woodhall Trust. Date 30th August 1969. The market average is represented by the p/e [illegible] FT. Actua[illegible] 500 share index. The average for the year [illegible] m[illegible] 16·2, the average for the Moodie index

First, that the Commission will have more evidence upon which to base its judgement. This is a matter that can be remedied. No-one is content with the flow of information either during a bid or in annual reporting. But the remedy for this lies elsewhere. Our company legislation, even after the 1968 Act, is very deficient in many respects. But, even if the Commission does have more information, the judgment must rest upon an assessment of probabilities based on the opinions of the parties. The facts about management performance are or could be made available to the market just as readily as to the Commission.

The other argument that shareholders are too likely to be preoccupied with personal and financial implications to be concerned with future profit prospects is very odd. It assumes very unsophisticated investors. Whether they sell their new shares or not does not matter. If they sell, someone who takes a view of the efficiency of the new group buys them. What matters is that the market rating of the acquiring company reflects the market view of the new profit prospects. If the bid is fended off then the defending company has been set a target which can be a powerful managerial stimulus. One of the great advantages of leaving take-over activity to the market is the spur which the threat of take-over can provide to otherwise sleepy management. This is not to deny that the market mechanism would be greatly improved by more disclosure both in annual reports and at the time of a bid.[18]

I believe in a way the Monopolies Commission has in its merger reports, claimed too much. The best test, though an imperfect one, of future performance is likely to be present and past performance. Statements of intent in bid situations are notoriously unreliable.

Conclusion

I come to no very clear conclusion. From the point of view of the firm I believe the pragmatic approach is best, even though it has led to some odd decisions. I do, however, believe that there is probably too much emphasis on anti-trust. Managers often do feel there is too intense a crusading spirit, too much apparently hostile investigation. Above all there is too much time spent. To any firm involved or likely to be involved in any investigation it is difficult to give advice.

From the point of view of the Government interested in the economy as a system I believe the greatest good for efficiency could come from a positive stimulation of competition. A much more rigorous Company Law, a strengthening of the hands of shareholders and encouragement for small and medium firms would make for a more effective market mechanism. Growth of the firm comes from the conscious decisions of managers and to put pressure on them implies both a positive set of inducements and a set of penalties. Despite considerable advances in our knowledge of the managerial process, it is far from clear that we know clearly enough how to improve the process of managerial decision-taking in such a way that growth is stimulated.[19] The market can provide penalties for failure and capital for the successful but market mechanism has been considerably weakened by legislation. With nothing to put in its place, this may have been a mistake.

One of the points that emerges without dispute from discussion of British monopoly policy is that we do not know enough about several important essential elements.

(a) How important are economies of scale? The kind of economies at the plant level which are often believed to produce social benefits may be 'dissipated' by the administrative diseconomies of large scale organizations and by a diminution of competition. From the social point of view it is hard to see what long-run benefits are gained from some of the large-scale economies (e.g. predatory buying policies) which are internal to the firm.
(b) What are the motives for conglomerate type mergers? What happens to the constituent firms if they are disallowed? When firms grow by acquisition what pattern of behaviour is postulated for their management? What forces will preserve that behaviour?
(c) How important is size for innovative activity?
(d) Why do large companies which have lost their motive force not grow smaller? What are the effects on the economy of this?

These are all important research areas, few of which have yet been adequately illuminated. Certainly we do not know enough about them confidently to pursue a policy favouring large size. A policy of monopoly control which is essentially negative needs to be supplemented by a policy of encouraging competitive forces, and this means reducing the barriers to growth faced by small and medium companies.

18 The Monopolies Commission should lend its support to the pressure for full disclosure of all profit sources.

19 I would refer here particularly to the work of R M Cyert and J G March, *A Behavioural Theory of the Firm*. See, also R M Cyert and K D George, 'Competition, Growth and Efficiency', *Economic Journal*, March 1969.

2.4 Competition, firm behaviour, and some effects of the German legislation on restrictive practices

W Benisch

I Preliminary remarks

According to the notes given for the preparation of this subject by the organizers of the conference, the foremost question is in what way and to what degree restrictive business practices legislation has affected [illegible]

of competition and to improve their performance and that its effect on ill-intentioned firms has been to induce them to contrive new ways to escape from competition. Such an interpretation of the relations between restrictive business practices legislation and firms' behaviour, however, appears to be somewhat primitive and cannot be demonstrated in any representative spread of cases. If this account was correct, firms in countries with a mild form of restrictive practices legislation like Switzerland, the Netherlands and Sweden, or in countries such as Italy where there is no law at all against restraint of competition, should be less efficient compared with their counterparts in other countries where the law against restraint of competition is more stringent, as in Germany, France and Great Britain. Such a relationship obviously does not correspond to actual conditions.

At the outset of this paper, therefore, I would say that the influence of restrictive practices legislation on the behaviour of firms should not be over-estimated. With free access to the markets, competition is already so acute even without any such regulations, and the driving force of firms for improved performance and progress is so strong, that a dynamic economy is assured.

Of course a law against restraint of competition along such lines can have an auxiliary function by removing obstacles that are detrimental to competition and to individual freedom of action, and by providing an atmosphere that is generally favourable to competition. The extent to which restrictive practices legislation influences firms' decisions, especially in relation to other conditions imposed by the state, however, cannot normally be quantified. And so the thesis that the rules of competition contained in the EEC Treaty are largely responsible for the Community's economic drive is one that I would describe as simply unrealistic. The majority of firms do not know these rules at all and have never come into contact with them—with the exception of the special case of the exclusive dealing contracts. Concrete effects of restrictive practices legislation on firms' behaviour can only be ascertained in cases where a restrictive practices legislation procedure has actually taken place or where such procedure was to be avoided. I shall be speaking about the observations made in these cases in the second part of my paper. In the first part I want to deal with the more serious issue of the influence of competition—not of restrictive business practices legislation—on firms' behaviour. It is left open whether this influence is directly increased by restrictive business practices legislation, and if so to what extent.[1]

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II The effects of competition on firm behaviour

1 THE FUNCTION OF STIMULATION AND ADAPTATION

Of the known macro-economic functions of competition, the following factors are of importance on account of their direct effect on the individual firm.

(a) *Stimulation* to better performance especially by cost-saving rationalization, improved quality, new products, better service;
(b) *Adaptation* of supply to demand by changing the amount of the supply, combination of supply and firm structure.

The effectiveness of these functions of competition is so self-evident that it is not necessary to go into any greater detail here. However, I would not agree with the converse conclusion that in the complete or partial absence of competition, there would be no stimulus to improved performance. It cannot be said that in the post-war years of reconstruction and recovery, when supply was unable to keep pace with demand, there was any lack of vigour on the part of industrial enterprises. However, the era of recovery also made it possible for firms to survive which, as regards their efficiency and structure, would not have been able to

[1] According to the subject of this working group it is not my task to supply a scientific well-founded picture, but to give an account of practical experience. In addition to it I feel not petent, to report experiences of other [illegible] However pose that my observations relative [illegible] EEC parallel with other countries.

for soap and heating oil which broke up almost as soon as they started, though for the latter this had been at the suggestion of the Minister of Economics.[3] How greatly the German entrepreneur tends to go it alone in the field of competition was shown in 1963 when an era of promoting co-operation started in economic policy. In order to gain the support of entrepreneurs for the idea of co-operation, the state and the industrial federations had to organize a regular publicity campaign. Using public funds, whole branches of industry were examined in order to advise the firms concerned how to gain improved efficiency and rationalization advantages by way of joint institutions.

One direct effect of the prohibition of cartels on firms' behaviour can be seen in those cases in which permission for a cartel was not granted or in which, once given, it was withdrawn again.

(*a*) The effect became most evident in the case of the common selling organizations which had been in existence *for many years* and in some cases for decades especially in the sectors 'rock and earth' and fertilizers. In this context it may be said that the adverse decisions of the Federal Cartel Office affected homogeneous bulk goods exclusively, which is easily explained by the fact that heterogeneous goods sold via joint sales organization (e.g. various kinds of agricultural machines or fittings) were not in competition with each other or at least only weakly. After their abolition, the common selling cartels usually chose the alternative way which the German restrictive practices legislation leaves open and to which the Cartel Authority clearly drew the attention of the firms concerned; this was the operation of a common selling agency, on the condition that the manufacturers concerned should be legally and in fact free to sell direct to customers. It is a peculiarity of German restrictive practices legislation—in contrast to the law of the European communities and other individual countries—that the definition of cartel only includes binding contracts with restrictive obligations (e.g. exclusive dealing), but leaves competition restraining effects out of consideration, a reasonable and distinct regulation which allows sufficient competition and has proved a success. The common sales agencies, the cohesion of which has weakened, have had great difficulty in asserting themselves vis-à-vis their members, their customers and the cartel authorities to which they are suspect. They function only with a small number of participants and when they offer their members and customers special facilities (uniform exploitation of production capacity, rapid handling of orders, rationalization of transport, credit advantages etc.). As soon as the direct sales of the member firms *exceed* a certain limit (about 20 per cent), the sales agency collapses. If the direct sales are *under* a certain limit (about 10 per cent), the cartel authority threatens the co-operation with dissolution. In addition there is the competitive clash with outsiders, other sales agencies and substitute goods. As an example mention may be made of the cement selling organization of Westphalia consisting of thirty-one works; this collapsed after only a few weeks as a result of the direct sales effected by its members. Since then a price war has started which will inevitably force a considerable number of firms to go out of business. Up to now six works have been acquired by competitors.

From the experience so far with the dissolution of common sales organizations, it can be said that competition has become keener. On the other hand middle sized groups still in existence are in danger. If the restrictive practices law now also would destroy presently existing forms of co-operation that permit competition, concentration in the sector of homogeneous goods will continue rapidly. Even now some co-operation groups are already thinking of forming corporate bodies or merging.

(b) The effects of the ban on cartels can be less clearly detected in branches where permission for a cartel was withheld from the outset or where, owing to the unlikelihood of permission, existing interest in forming a cartel could not be realized. In some of these sectors, however, a powerful shifting of the balance towards the large firms and a development towards concentration can be detected. As an example I would mention the manufacturers of sugar: In the course of removing the legal market ordinances for sugar, the producers, for the present, had formed common sales agencies on the above-mentioned free basis, because there was no probability to get an authoritative approval for exclusive dealing. The mentioned difficulties for common selling mass products in the absence of binding dealing contracts resulted in efforts to merge. The Government of Niedersachsen even recommended the amalgamation of thirty sugar factories in northern Germany for solving the structural problems.

My federation has always advocated the view that the ban on cartels would result in a pressure towards concentration, but this the supporters of the ban strongly denied. In the meantime, however, they are adopting this argument in order to substantiate the need for control over mergers.

2 THE BANNING OF VERTICAL AGREEMENTS

In the sector of vertical agreements, German restrictive practices legislation forbids resale price maintenance agreements whilst allowing a few agreements to remain for branded articles. EEC law forbids exclusive dealing contracts in so far as the sales areas are protected against sales by third parties. The following effects of these prohibitions can be stated:

(a) In so far as resale price maintenance agreements were annulled owing to frequent under-cutting, it was possible to detect at first a noticeable drop in prices in relation to the maintained price. This arose from the fact that dealers exploited the comparison with the previously maintained price for advertising purposes. When this advertising incentive slackened, the prices started to rise again, although not to the level of the formerly maintained price. In some cases, however, the manufacturer was compelled to replace the product or packaging which, in the eyes of the

3 Other reasons for lacking interest in restrictive agreements are—as Mr Brittan mentioned in the first working group—full employment and good order books.

trade and the consumer had been devalued, by a different finish, by creating a new brand. The abolition of resale price maintenance in a whole line of business has furthermore had the effect of increasing the share in the market of the better known brands—mostly of the big firms—so that the smaller manufacturers were at a disadvantage (e.g. in the case of chocolate and spirits).[4] As the sales market cannot exist without a certain measure of supervision and order—in relation also to prices—the ban on price maintenance led to the following substitutes in place of it:

(i) Change-over to resale price recommendations which, however, are only permissible so long as they correspond to actual market conditions. The price recommendation thus serves only as a guide to the consumer. The soaring increase in the number of registered vertical price recommendations during the last few years that can be gathered from the reports of the Federal Cartel Office is due, incidentally, not so much to an actual increase in the use of recommended prices as to the fact that the manufacturers only decided to register their gross prices gradually under pressure from the cartel authorities.

(ii) Increase in trade marks of vertically integrated distributive trade groups which are not affected by legislation. These trade marks often remain outside the scope of price competition and constitute the backbone of the assortment in each group. Manufacturers' brands, on the other hand, are used for advertising purposes, as 'loss leaders'. For the manufacturers, this development means that they are losing their leadership position in marketing to the distributive trade.

(iii) Few manufacturers are in a position to exercise influence on the fixing of the price to be paid by the final consumer, by themselves approaching the final consumer through agents or through their own direct sales organizations.

to prices.

solve the problem that dealers are only ready to take on a particular foreign not yet famous branded article which is not so far well-known and push it with all their resources if they are guaranteed exclusive sales rights The manufacturers therefore seek other ways of achieving optimal sales in other EEC countries Amongst the possibilities that occur in practice, the following may be mentioned:

The establishment of their own factories or sales organizations in the neighbouring country (this is

to prevent the article being resold in other countries.

Supplying the retail trade direct to the exclusion of the wholesaler;

Employment of sales agents on whom exclusive restrictions may be imposed;

In the case of products with a strong position on the market such as some makes of automobile—the latent danger to the dealer of losing his franchise if he does not adhere to the manufacturer's sales system.

I doubt whether these substitute solutions correspond to the aims which cartel legislation pursues in its restriction of exclusive dealing contracts.

3 MARKET DOMINANCE AND CONCENTRATION

In this sector of restrictive practices legislation no experience has yet been gained from the EEC, and only very little from the German point of view. The only factor of greater consequence in Germany has been the repeated attempts by the Cartel Authority to produce proof of abuse of their market position by the large oil companies. These were occasioned sometimes by the uniform prices, sometimes by differing prices. Representatives of the oil companies declared that whatever they did, it would probably never suit the cartel authorities. Therefore the only action left open to the firms is for them to be prepared at all times to adopt a new procedure. In the last report of the cartel office, it was confirmed that the oil companies were maintaining adequate price competition.[6]

In mergers of significance in terms of market dominance, German law provides for the possibility of public negotiation with the firms involved, although without this having any legal consequences. The Federal Cartel Office has so far only made use of this public negotiation provision once (in the case of ladies' stockings) and in this case it was unable to find any position of market dominance. The cartel office does not expect negotiation to lead to any check on concentration and is asking for more power to take decisions. In giving up the procedure of negotiation,

[4] Simultaneously—as Sir Hugh Weeks reported on British experience—this trend caused an increase in grocery-type sales, especially in supermarkets, and a decline in independent confectioners.

[5] This possibility is largely made use of also by American producers of branded articles, though jurisdiction on this topic gradually is becoming more severe.

[6] However the Cartel Authority took new proceedings relative to the prices asked by motorway stations, and requested their reduction to a level which is not higher than the average of the next situated two country stations. The cartel authorities' permanent pressure on the oil companies has resulted in service station prices that are the lowest in Europe. But the reverse of this success is the ruin of the last genuine German petrol company Frisia on account of the impossibility to cover costs. Only the big foreign oil companies disposing of own oil sources are able to withstand this deadly competition. Thus we meet a ex-ample of impact of restrictive business practices centration.

it is not acting in accordance with the judicial function with which it was entrusted. The use of public negotiation would be quite suitable as a means of providing objective public enlightenment as to whether there is really any danger of concentration such as is persistently claimed by some political and scientific circles and especially by some newspapers. But apart from this it cannot be maintained that the duty of firms to justify their mergers in public has no influence on their decisions.

IV Conclusion

The effects of the law against restrictive business practices on the behaviour of firms can only be ascertained with certainty where legal prohibitions or decisions by the cartel authorities have intervened in existing settlements or legal positions. The short-term effect is mostly more lively competition. Taking the longer view, however, such intervention is the cause of new forms or structural changes, which in their turn, come under suspicion for showing a lack of competition or inadequate competition. We know how the Americans during the past few decades have constantly aggravated their legislation, control and jurisdiction in this field, because the results it produced were unsatisfactory. At present new proposals arise in relation to conglomerates and individual firms. Again and again new faulty developments have emerged—from the point of view of the ideal of competition. Will this ideal ever be reached? Or will not a constant expansion and complication of the law against restrictive business practices ultimately lead to a form of state control which would be detrimental for the spirit of enterprise, or at least would injure the system of competition between firms able freely to take their own decisions?

2.5 Firm behaviour and policy on mergers in Japan

Y Kanazawa

I Introduction

Today in Japan when liberalization of trade, exchange and capital transactions are being promoted, the Japanese Anti-monopoly Act[1] stands at a point of challenge. This is because, on the one hand, there exists a view in the business world and some parts of the Government which holds that the Anti-monopoly Act operates as an obstacle against the strengthening of international competitive powers of the domestic enterprises, which is so necessary a counter-measure to liberalization. On the other hand, there is a prevailing opinion in the academic circles that the spirit of the Anti-monopoly Act must be maintained in principle. An important problem imposed upon the anti-monopoly policy of Japan today is, therefore, to reconcile these two opposing views.

This problem significantly appears in the merger [illegible]

[illegible]

of the same year two big steel manufacturing companies announced similar intentions.[3] Taking this opportunity, the Ministry of International Trade and Industry (MITI) established a Special Committee[4] to Study Basic Problems (Kihonmondai Tokubetsu [illegible]

[illegible]

mergers. From the conclusion of this study, one can notice that the Committee took great pains to adjust the above-mentioned views in a rather delicate expression, stating as follows:

> At present, enterprises of various countries are endeavouring toward the enlargement of enterprise scale and managerial efficiency in meeting with the rapid technological development. Even for our industries, to win in the international competition of world current, they must strongly promote improvement of structure through mergers. As to the possibility of restraint of competition by mergers, case by case examination is necessary, and particularly careful examination is necessary with regard to mergers of big business. However, considering the actual economic conditions of Japan, generally speaking, for some time to come, the possibility of restraint of competition is slight. However, the Government should always watch by paying full attention to prevent restraint of competition in order to maintain effective competition.

In view of the present situation as mentioned above, this paper will deal chiefly with mergers

II General attitude of business toward Anti-monopoly Act

[illegible]

beginning that the Japanese Anti-monopoly Act was too severe and not suitable to the actual economic

[illegible]

important industrial organizations, the following result appeared:

1 The application of the Act should be made more realistically 42·6%
2 The Act should be amended to relax it more 36·3%
3 The Act as it is enforced is satisfactory 15·6%

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1 Act Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade (Act No 54, April 14, 1947), as amended by Law No. 214 of June 18, 1947 and Law No. 259 of Sept. 1, 1953 (Hereinafter cited as the Anti-monopoly Act.) For text in English, see *Guide to Legislation on Restrictive Business Practices*, Vol. 4, Japan, Sec. 1 0 (1967) published by the Organization for Economic Co-operation and Development.

2 This merger plan was called off before it was reported to the Fair Trade Commission in their anticipation that the Commission [illegible]

the academic circle, eleven from the business circle and three from the newspaper field and of economic critics with Mr Hiromi Arisawa as Chairman (total seventeen members).

3 Yoshio Kanazawa, the regulation of [illegible] ate F[illegible] The law of unfair competition and the [illegible] *Law in Japan*, 1963, p. 487.

4 Keizaidoyukai, 'Managemen[illegible] *The reality of business decision* pp. 56 et seq

4 Number of exemption laws should be increased 3·5%

There was no enterprise which answered that the Act should be amended to make it more severe. Looking at the replies by size of companies, those which answered 'amendments should be made so that its regulation is more relaxed' were on the hole large companies, and those which answered 'the Act as it is enforced is satisfactory' were small companies.

Further, the Federation of Economic Organization (Keizaidantai Rengokai), another powerful industrial organization, conducted a similar investigation in March 1969.[7] In the summary of report, there are noted such views as 'there is a lag between the Act and the actual economic condition', 'there should be a shift in application of the Act from general prohibition of restrictive practices to control of abuses'....

This trend is increasingly intensified with the progress of liberalization of trade, exchange and capital transactions . . . that is to say, open economic system. This is because the need for strengthening international competitive powers of the domestic enterprises is being requested in view of liberalization. Particularly the enlargement of enterprise size through mergers is being strongly voiced. The report titled *Mergers and Anti-monopoly Policy* of 1969 made by the Anti-monopoly Act Study Group of the Federation of Economic Organizations states as follows:

Our industries are in the world-wide movement of economic internationalization as expressed by liberalization of capital transactions and removal of trade barriers. This means the advent of the era in which world enterprises will do active business in the arena of international markets. Under these circumstances, the area of competition is widened to world-wide scale, and types of competition are diversified.

As for our industries, it has become an unavoidable task for them to meet the challenges of world-wide enterprises as well as advancing themselves as world-wide enterprises in order to insure their independence and future development. Careful consideration should be given so that the Anti-monopoly policy, which is a part of the economic policy, does not work as a hindrance to the necessary reorganization of industries and to the endeavours for strengthening of enterprises by working anti to the direction of such task and endeavours of the economic world.

III Regulation of mergers[8]

The Anti-monopoly Act as present enforced provides that no company shall effect a merger in either of the following cases 'where the effect of a merger may be to substantially restrain competition in any particular field of trade' or 'where unfair business practices have been employed in the course of the merger or consolidation' (Section 15 (1)). In practice, mainly the former provision is at issue now. According to the prevailing interpretation the term 'where the effect of a merger may be to substantially restrain competition' means situations where a market dominating power is formed, in other words, the situation where effective competition in the market is lost.[9] Under the Japanese Anti-monopoly Act, the parties to a merger must file a prior notification to the Fair Trade Commission (Section 15 (2)) and cannot merge until, as a rule, thirty days have elapsed since filing. The Commission, during this period if it thinks there is a violation, should issue a complaint or a recommendation to the proposed merger (Section 15 (4), Section 48, Section 49) in order to eliminate violation by such merger (Section 17–2).[10] Therefore, the Commission must judge in advance whether or not the proposed merger 'may be to substantially restrain competition in any particular field of trade'. With regard to the criteria for such judgment, it was held once that 30 per cent market share after merger was a danger signal.[11] However, since the memorandum exchanged between the Secretary-General of the Commission and the Vice-Minister of the Ministry of International Trade and Industry in November 24, 1966,[12] it has become clear that various factors have to be considered jointly for such judgement. This memorandum states as follows:

(4) In regard to merger, the following competitive aspects in the industry concerned will be fully taken into account, in addition to market share of a company established by merger, numbers of companies, ranking of each merging company prior to merger and of a company established by merger, etc:
 (i) Comparison of economic power with competitors;
 (ii) Business conditions of enterprises in related industries;
 (iii) Conditions of new entry (including entry of foreign enterprises);
 (iv) Competitive relation with substitutes;
 (v) Competitive relation with imported goods.

The view expressed in the memorandum is generally considered proper. The Commission has always judged when illegality of merger was at issue with the same stand as stated above and thus this memorandum in no way changed the view of the Commission.

IV General picture concerning mergers

In Japan, every merger of corporations must be reported to the Fair Trade Commission. Therefore, the Commission is in a position to know of the contents of mergers. Let us look at the general picture

7 Keizaidantairengokai, *Summary of the result of the investigation by questionnaires conducted by a study group of the Anti-monopoly Act*, March 1969.
8 As to the details of the regulation of mergers by the Anti-monopoly Act, *see* Ariga, supra. With regard to regulation of business by the Act including merger regulation, see Kanazawa, supra.

9 The Commission, in *Toho v. FTC* (Decision of Tokyo High Court, 19 September 1951) states in its response that 'substantial restraint of competition in the Anti-monopoly Act means the same as "effective" restraint of competition and points to a situation where effective is almost impossible to be expected'. The Tokyo High Court, in the same case, says that 'substantial restraint of competition means a situation where the control of a market is effected or is about to be effected'.
10 Hiroshi Iyori, *Anti-monopoly Legislation in Japan*, 1969, p. 67.
11 The former Chairman of the Commission, Mr M Yokota, said in the Committee of Commerce and Industry of the House of Council in 1955 that 'as a general guideline, a 30 per cent marke share of a company after merger is considered a dangerous concentration. If it comes to 50 per cent, the possibility of the merge projects passing the FTC's screening is very remote'.
12 This exchange of memorandum was done in a form where the Vice-Minister of MITI expressed its view to the Secretary-Genera of the Commission and the latter agreed with it. Therefore, the content of this memorandum is interpreted not to bind the commissioners.

of mergers by the relevant materials of the Commission.[13]

1 TREND OF NUMBER OF MERGERS

During the ten year period of 1950 to 1960, the number of mergers was between 300 and 400 annually. However, the number increased since 1961, and in 1963 it went up to 997. Since then, the number ranged between 800 and 1,000 annually until today.

The changes in the numbers do not necessarily correlate with the ups and downs of business conditions. Recently, even though business is booming there is considerable number of mergers[14]

2 MERGERS CLASSIFIED BY SIZES

In the last six years, 5,514 mergers have been effected Classified according to the size of capital, it is as follows:

Less than 50,000,000 yen	4,255	77·3%
More than 50,000,000 yen but less than 100,000,000 yen	1,244	22·7%
More than 100,000,000 yen	259	4·7%

As the figures above indicate, the majority of mergers are those between small and medium enterprises. However, mergers of big enterprises should be noted, since there have been some as follows.

The number of mergers where capital after merger increased to more than 10,000,000,000 yen:

1963	9	1966	5
1964	9	1967	7
1965	3	April of 1968 to Sept. 1969	5

3 THE REASONS FOR MERGER

There are various reasons for mergers. However, managerial rationalization is by far the greatest. With regard to mergers in the past six years, the reasons can be classified as follows

(a) *Rationalization of management*

Those mergers whose objective was to rationalize management of enterprises occupy 78·17 per cent of the whole. Managerial rationalization can be broken down as (1) strengthening of sales effort, (2) increase of capital value, (3) strengthening of credit status, (4) diversification of activities, (5) integration of production and sales processes, (6) mass production, (7) rationalization of distribution processes, (8) enlargement of scale and (9) others These objectives are often correlated with each other.

(b) *Liquidation of the company to be merged*

Mergers are sometimes made in order to liquidate failing companies This kind of merger occupies 7 8 per cent. This type of merger occurs very often between enterprises belonging to the same affiliation. For example, the parent company may absorb a failing subsidiary. Sometimes, the failing parent company may try to get out of its difficulties by absorbing subsidiaries.

(c) *Acquisition of failing companies*

Sometimes companies absorb competitors which are failing in their business because of intensive competition. Further, a small company and other failing company might be acquired by an enterprise desirous of enlarging its scale of activities. This kind of merger occupies 1.3 per cent.

V The principal examples of merger

In Japan, there are approximately 1,000 mergers annually in recent years. The majority are mergers of small and medium size companies and there are no anti-monopoly problems Four mergers where anti-monopoly violations seemed to appear will be given The first three mergers were allowed. The last is still pending due to hearing procedure at the time of the writing of this report. Except this last case, there has been no instance in which the Fair Trade Commission filed a complaint against merger.

1 *Merger of Yukijirushi Nyugyo Company (Snow Brand Dairy Company) and Clover Nyugyo Company (Clover Dairy Company) (1958)*

The market share of these two companies in Hokkaido after merger would amount to 57·7 per cent in respect to butter, 76 per cent in respect to cheese and 75 per cent in respect to raw milk collection Judging from these factors, it would seem that substantial restraint of competition in these particular fields of [illegible]

fresh milk becomes excessive. (2) These companies collect milk from producers located in Hokkaido, so there is a limit to processing the milk as fresh drinking milk. The raw milk must be used for producing milk products like butter, cheese, etc. (3) So far as the situation in Hokkaido is concerned, there seem to be no cases of forcing the buying price of raw milk down (4) There existed powerful competitors like Morinaga Nyugyo Company (Morinaga Dairy Company) and Meiji Nyugyo Company (Meiji Dairy Company)

2 *Case of Chuoreni Company and Teikoku Senma Company (1959)*

After merger of these companies, the market share would rise to 56 8 per cent in linen thread. How the Commission thought that the k share after this merger would be

[13] Jotaro Yabe (a Staff Office member of the Fair Trade Commission), 'Kigyogappei. Eigyo No Yuzuruuke No Doko', (Trend of Mergers and Acquisitions), *Shojihomu Kenkyu*, No. 487 (5 June 1969)

[14] Arga, ibid., pp. 115–16.

considering the relationship of substitutes between linen and synthetic fibre, and so the merger was granted.

3 Case of three Mitsubishi heavy industry companies: Mitsubishi Nihon Jukogyo Company, Shin-Mitsubishi Jukogyo Company, Mitsubishi Zosen Company (1963)

This merger attracted wide attention both in Japan and abroad as a resurrection of the huge enterprise which was the centre of the Mitsubishi Zaibatsu.

The market share of the company after merger would be 28 per cent in ship-building, 27 per cent in ship repairwork, 27 per cent in diesel engines for ships, 27 per cent in turbines for ships, 24 per cent in turbines propelled by fuel for the generation of electricity, 46 per cent in boilers for the same purposes, 34–42 per cent in turbines and boilers for general factories, 63 per cent for paper manufacturing machines, 25 per cent in trucks and 26 per cent in buses. The Commission judged that this merger can be granted even if the market shares would become high since the market control by this merger would be difficult due to the fact that (1) powerful competitors exist in each field, (2) competition with foreign firms is intensive in each field and (3) these products, except automobiles, are produced on the basis of production by order of customers and mass production is difficult, and users' position is strong, and the amount of orders greatly changes from time to time. However, in respect to paper manufacturing machines in which the market share of these companies was very high, the Commission requested the parties to cancel either one of the patent licence contracts made between each of these companies and the two foreign entities, since otherwise the company after the merger would own the technologies of these two foreign entities and thereby substantial restraint of competition might result.

As mentioned before, this merger was regarded by critics as the resurgence of the former Mitsubishi Zaibatsu company. In particular, the foci of argument were on the following three points.

(1) Is it all right to grant mergers of companies dissolved by the Elimination of Excessive Concentration of Economic Power Act? (2) Would this merger not result in the resurgence of the former Zaibatsu? (3) Is there really no danger of market control in the future by the consolidated powers of this enterprise? The Commission took the following attitude toward them. As to (1), it held that the Elimination of Excessive Concentration of Economic Power Act was enacted with a specific objective in view, and thereafter economic conditions have considerably changed. Therefore, whether the merger is permissible or not should be judged from the stand-point of the existing Antimonopoly Act. In regard to (2), it held that this merger would not mean the resurgence of the former Zaibatsu which had a holding company at its head. And concerning (3), it held that in those fields of industry where the company after merger would exercise consolidated powers of enterprise . . . for example, automobile, industrial machinery, etc. . . . there are powerful competitors both domestically and internationally. Therefore, it is unlikely that domination of market would occur by this merger.

4 Case of Yawata Iron & Steel Co, Ltd and Fuji Iron & Steel Co, Ltd

These two companies concluded a contract for merger in March, 1969, and notified it to the Fair Trade Commission. The Commission, believing that this merger would violate Section 15(1)i of the Antimonopoly Act, issued a recommendation on May 7 1969, in accordance with Section 48(1) of the Act that the proposed merger should be called off. But the companies refused to accept the recommendation. Thereupon on March 19 the Commission commenced a proceeding by issuing a complaint on this proposed merger and the proceeding is now in progress. With respect to the proposed merger, the companies stand on the premise that in the steel industries where big scale companies are common throughout the world competition among big enterprises in world-wide scale with full power has become 'intensified with progress of economic development'. 'To cope with this situation, it is necessary to enlarge size of enterprise and strengthen its structure'.

The merits of the merger as maintained by these companies are as follows:

1 Increase of efficiency in investments.

(a) It makes concentrated investments on important sectors possible.
(b) It makes the construction of large scale facilities and their efficient operation easy.
(c) It makes replacement of facilities easy.

2 Technological development power is strengthened and research investment efficiency is carried out.

(a) Duplication research can be avoided and thereby research on important theme can be carried out more efficiently.
(b) It would contribute to enlargement of the research organization and strengthening of research investment power so that development of large project becomes possible.
(c) Accumulation of information regarding technology can be improved.

3 Materials of various kinds coming in large quantities can be classified by kind and concentrated: thereby efficient use of the materials can be made, and transportation rationalized.
4 It would make possible rational concentrated distribution by product and specification to plant.
5 It would avoid waste of cross transportation of products.
6 It would improve sales and service activities.
7 It would rationalize management and make better use of computers.
8 It would facilitate obtaining of capital.
9 Foreign activities would be more greatly strengthened.
10 Consolidated business power would increase.

However, the Commission, in spite of the alleged merits of the merger, issued the recommendation in the belief that this merger would violate the Antimonopoly Act. The points of violation which the Commission alleged in the recommendation are that, among the entire products produced by these com-

panies, competition might be substantially restrained in each of the four product lines, namely rails for

61·2 per cent in tin plate for cans, 56·3 per cent in foundry pig iron and 98 3 per cent in steel sheet pile The Commission, besides the above mentioned market shares, also taking into consideration whether newcomers exist or not, whether powerful competitors exist or not and other factors, reached the conclusion that substantial restraint of competition would result in the above mentioned four product lines.

VI Various problems relating to merger

academic circle and government Let us see what are the major points.

1 LEGAL INTERPRETATION

(a) *Any particular field of trade*

domestic market as a 'particular field of trade' should not be ignored in the application of the Act

(b) *Evaluation of consolidated power of enterprise*

There is a view that in the determination of illegality of merger, consolidated power of merging companies should be taken into consideration and that it is not proper to judge only whether substantial restraint of competition in individual item of products results [16] According to this view, in the proposed merger of Yawata and Fuji as well as that of Mitsubishi three heavy industry companies, suspect of violation by merger would be great because consolidated power after merger is very great. However, the Anti-monopoly Act as presently enforced does not place entrepreneurs under subject of control solely because their capital is great or that their activities extend to diversified fields Therefore, the consolidated power of enterprise does not necessarily have to be considered in the regulation of merger However, indirect influence of such consolidated power of enterprise upon substantial restraint of competition in each item of products should perhaps be considered In the case of the proposed merger between Yawata and Fuji, the fact that the market share of these companies in the field of crude steel is considerably high is worthy of being considered from this standpoint

(c) *Prospect for effective competition*

Under the Anti-monopoly Act, prior screening regulation is enforced against mergers Therefore, the prospect that 'competition may be substantially restrained' is needed The point whether its possibility is sufficient or its probability is necessary is at issue [17] In legal interpretation, its probability is considered necessary

It is not an overstatement that the substantial argument regarding mergers centres on the prospect of effective competition The reason why a big merger becomes an issue is that oligopoly may be promoted and particularly the fear of emergence of administered prices

The opponents of a big merger believe that effective competition will not exist any more if the degree of *concentration in the industry concerned becomes high* due to the merger. However, even if such occurs theoretically, the application of the Anti-monopoly Act must be made by 'case-by-case' approach.

2 POLICY ARGUMENT

(a) *The relationship between anti-monopoly policy and the other economic or industrial policy*

In the business world, there is a strong opinion that, evaluating the merits of mergers very highly from the standpoint of national economy in the context of today's economic internationalization, big mergers

industry hereafter . . . it is necessary to enlarge scale of enterprise. For this purpose, promotion of mergers and business co-operation under system of effective competition is urgently needed.'[18]

On the other hand, many economists maintain that 'preservation of competitive conditions which is the *spirit of the Anti-monopoly Act must also be the basic*

might be some benefit by the enlargement of scale by merger, it might not be so great', or 'benefit by

[16] Study Group established by Keizaidantai Rengokai states in its report of 10 June 1969 titled *Gappei to Dokkinseisaku ni Kansuru Kenkai* (Opinion with regard to Mergers and Anti-monopoly Policy) as follows 'Although our economy has grown rapidly,

[17] Many economists hold that the merger should be rejected if there is a possibility for substantial restraint of competition.

[18] Decision of Cabinet regarding government policy toward steel (29 July 1969) See *Nihon Keizai Shimbun* of that date.

enlargement of scale might be nil and, on the contrary, efficiency might be decreased thereby'.[19] Even in the business world, there is a view opposing amendment toward the direction of relaxation of the Antimonopoly Act. This view holds that 'creativity is the motive of competition' and 'competitive power of enterprise means that there is creativity in the enterprise research and development', and 'size of enterprise or amount of financial power is not so important'.[20] This view is worthy of attention.

(b) *How to regulate*

There is a view, as a legislative policy, that the method of prior-regulation system under the present Antimonopoly Act should be changed to post-regulation system, and it is sufficient to eliminate the evils afterwards if evils accrued from mergers. However, earlier, particularly at the time of the amendment of the Anti-monopoly Act in 1953, the controlling view was that post-regulation system of merger was not desirable because it would place the company formed by merger in legal insecurity. This view is still held today.

VII Conclusion

After World War II, anti-monopoly legislations have considerably spread both internationally and nationally.[21] This is a remarkable phenomenon especially as compared with the pre-war era when such legislation was seen only in the United States and very few other countries. In examining the arguments surrounding the recent mergers of Japan, it is necessary first of all to reflect upon the idea which gave birth to this fact.

Today's anti-monopoly legislation has, as its basic idea internationally or nationally, that development of economy is expected by maintenance of competitive economy, and its rigidity prevented thereby. In Japan, a view that mergers are necessary as a measure to cope with liberalization is strong. However, from the standpoint of the basic idea of the Anti-monopoly Act as above mentioned, the anti-monopoly policy must play increasingly important role as liberalization progresses. This is because even if liberalization is advanced on the one hand, if on the other hand monopolies advance, economy would become rigid and the merits of liberalization would be set off that much. Therefore, from a long-run perspective, anti-monopoly policy should be more tightly enforced in the era of internationalization and open economy.

Principally, this idea applies to mergers. In the case of Japan, if mergers are considered desirable from the standpoint of national economy, this demand can be met to a certain degree by the application of the present Act.

19 *Opinion about Mergers of Big Business* dated 15 June 1968, by a group of economists (90 members).
20 Vice-President of Honda Motor Company, *Watakushi no Iken—Kigyoseicho to Kyoso—Dokkinho-o Kenjiseyo.* (My Opinion—Development of Enterprise and Competition—the Anti-monopoly Act should be firmly maintained.) *See Nihon Keizai Shinbun*, 19 May 1969.
21 As multilateral treaties, *see* International Trade Organization Charter, Art. 46–Art. 54: Treaty of Rome establishing EEC, Art. 85 and Art. 86; Treaty establishing European Free Trade Area, Art. 15; Treaty establishing Organization for Economic Cooperation and Development, Art. 2. As bilateral treaties *see*, for example, Friendship, Commerce and Navigation Treaty between the United States and Japan, Art. 18.

Group 3
Market structure in relation to firm growth and innovation

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Group 3
Market structure in relation to firm growth and innovation

3.1 S Golt, Chairman's report

3.2 D F Turner and O E Williamson, 'Market structure in relation to technical and organisational innovation'

3.3 C Freeman, 'Size of firm, R and D, and innovation'

3.4 C Freeman, 'Innovation and size of firm'

3.5 H Suzuki, 'Big business mergers and anti-trust laws: a businessman's point of view'
(with an introduction by T Ikeuchi)

3.6 G Albrechtskirchinger, 'Market structure in relation to firm growth and innovation'

3.1 Chairman's report

S Golt

I think I must start by saying that I am lost in admiration at the range, complexity and generality of the topics which my fellow Chairmen so far contrived to cover in the period and the way in which they have presented them.

Our own remit in the third group was I think rather narrower than those of the two groups before us, and perhaps we treated it even more narrowly than the general heading might have warranted, chiefly because we had before us three extremely interesting and penetrating papers on one particular aspect of the subject, which was, primarily, the relationship between size and the tendencies to innovation in [illegible] reading of the papers which Professors Turner and Williamson, Dr Freeman and Dr Albrechtskirchinger put before us because of the particular interest of the treatment of the empirical material.

The general sense of the discussion in the group tended to the conclusion that no direct relationship between size and the innovation process as a whole could be established from the empirical material. Contributions to innovation were made by firms over the whole range of sizes in industry and in various ways Nor did it seem possible to establish any correlation of significance between size and the rate of diffusion of innovation.

But perhaps the most valuable part of the discussion in the Group emerged from the points that came out of all three of the papers which analysed the concept of innovation so as to demonstrate that this was not a single activity but a series of processes and events in the course of industry. Professors Turner and Williamson called this a systems approach and Dr Freeman drew an interesting and illuminating distinction between invention on the one hand and the development and marketing process on the other and the various stages within those which contributed to the whole process [illegible] there nonetheless appeared to be certain advantages which lay to some extent with large firms on account of three factors, particularly at the later stages of innovation—development and marketing One arose from the fact of the sheer cost of the necessity to construct the pilot plant, one from the necessity to examine multiple alternatives in the course of deciding on lines of advance and one from the cost of the contribution of fundamental research and contact with the total scientific and research background Some of these features are particularly relevant to what one might call the research-intensive industries and indeed they were illustrated from industries which have been thought of as exceptional in this respect But it was argued that increasingly, as this is a type which may become the model rather than the exception, in some of these respects and at these later stages of the process large firms may make a more than proportionate contribution At any rate it is in these respects that at least a minimum threshold of size becomes particularly important.

Nonetheless, firms of all sizes in an industry contribute to technical progressiveness, which is the continued lowering of costs of production through day-to-day improvements in productive techniques, and small firms in particular, it was argued, make a more than proportionate contribution to fundamental invention, although of course invention in itself is only the first stage, which may not become economically significant until development and the later stages of the operation have been completed. The case for having a spectrum of firm sizes to promote invention and innovation was qualified by the fact that it is possible for large firms to simulate, as Dr Freeman put it, the advantages of small firms, and this linked with the interesting point which Professor Turner made about organizational innovation and the potential role of the multi-divisional firm Indeed Professors Turner and Williamson saw the multi-divisional firm, which in some aspects one might see as the conglomerate firm, as the vehicle through which the small firms' advances in invention, which they were not able themselves effectively to exploit, could be given a wider significance. At the same time, small firms can achieve some of the advantages of large firms, or overcome some of their own disadvantages, where specialization enables them to achieve in their own narrower field what larger firms have to do over a much wider field It appeared therefore not appropriate to talk very much about the optimum size of firms, but to think more appropriately in terms of a

Mr Sidney Golt, CB is a Second Secretary of the Board of Trade.

cohort of firms of different sizes in an optimum structure for an industry. But no-one felt confident enough about the wisdom of governments to expect them to use their instruments of control sufficiently finely to produce such a spectrum.

Most of the empirical material on which this discussion was based is American. It was agreed that it is not really easy to translate this American material into European experience and there was indeed a general feeling that more needed to be done in the way of research in European conditions to provide a basis of knowledge. The University of Sussex has already begun work of this kind, and it was strongly felt in the group that further research should be encouraged by governments and others.

The discussion concentrated very heavily on the innovation aspects of size and structure. Of course, it was emphasized that this is only one factor, and by no means necessarily the most important factor, in consideration of the effects of size. It was felt however, from such discussion as we had, that a similarly intensive discussion on economics of scale generally, especially if one could make the sort of breakdown which we were able to make on innovation, might lead in, at any rate, a similar direction.

I must however qualify what I have said so far by making clear that a number of the members of the group emphasized the need to recognize that there were many situations where increases in size—very often achieved precisely through the mechanics of mergers—could give rise to clear improvements in efficiency and could benefit rather than produce detriment to the objectives of competition policy.

The trend of the discussion showed that many of the considerations which we were taking into account centred largely on absolute size rather than shares of market. This became particularly marked in trying to take a view on the applicability of us conclusions from the material to Europe and other countries. The United States participants in the discussion were perfectly clear that the analysis, with its neutrality as regards size-effect, called for no change in their competition policy approach based on arithmetical shares of their market, as far as the United States was concerned. But it did possibly leave open room for some transfer of activity from small to larger firms for the exploitation of ideas; and this might be best accomplished perhaps by conglomerate firms using the opportunity to enter new markets rather than by the sort of horizontal merger which United States legislation would preclude. They also did not rule out the possibility of some new studies of possible exceptions in particularly research-intensive industries.

For most of the Europeans the neutrality of the size consideration equally seemed to point to confirmation of a pragmatic approach, though of course it was readily accepted that it is easily possible to draw too sharply the distinction between the two approaches and that this is a pitfall to be avoided. The group certainly tried to avoid this pitfall in its discussion of the very interesting specific case of a particular Japanese merger which was discussed in the paper presented to us by Mr Suzuki and introduced by Mr Ikeuchi. What we had to do there, and I think we succeeded, was to eschew the temptation to turn ourselves into an unpaid international Monopolies Commission. We indeed did turn away from that course and returned to the general question, coming to the conclusion, for most of us I think anyway, that competition policy certainly needed to take account of market power to take market shares into consideration, but that the problem might often be, what was the relevant market in the circumstances of particular cases, and in particular, and perhaps especially for the United Kingdom, for competitiveness in international trade.

It seemed necessary to ensure, certainly, that scope must be given for achieving such advantages as size may give. Certainly not all the participants would agree that bigness for European purposes need be measured against American bigness, and some especially would argue that European expanding firms might profitably stop well short in their ambitions of the United States' giants. But there was a fairly general acceptance, I would judge, that there is still room in Europe, short of this situation, for some expansion in average size; and certainly that European firms need to reach the threshold necessary for efficient competitiveness, within the conditions I described, without of course undermining the advantages which have to come from competition and which are the basis on which governments are justified in having policies in that field.

It would be fair to say, however, that some, at any rate, of our colleagues from the Community, while accepting that the question of market size poses a problem from some countries (in the dilemma between high concentration so as to achieve economies of scale or, alternatively, to reach thresholds in research and development activities) would feel that as the Common Market approaches a higher degree of integration these constraints might very well not be experienced within the Community market, and they would see themselves as moving rather more towards the American approach on these matters than to what I think is the present British approach.

A point which is consequent on this (and on which I think there would have been no dissent at all generally in the Group or at any rate a very wide consensus in the Group) is that all of this points to the value, indeed necessity, of the removal of trade barriers and further measures of international economic integration. Progress in this direction would mitigate the dilemma between concentration and size.

3.2 Market structure in relation to technical and organizational innovation

D F Turner and O E Williamson*

Relations between market structure and performance are rarely simple. As will be apparent, none of the issues that we address in this paper qualify as an exception. Considering the inherently uncertain and complex character of the innovation process, this is hardly surprising.

Our principal purpose in the first two sections will be to unravel some of these complexities. The relations between technical innovation and market structure occupy our attention in Section I. The discussion here is mainly a review and interpretation of the earlier literature. Organizational innovation, which is a relatively neglected aspect of the innovation question, is examined in Section II. We attempt to pull organizational and technical aspects together in a systems framework in Section III. Policy implications of the argument are addressed in Section IV in the context of the following issue: to what extent does an otherwise well conceived antitrust policy require modification on account of progressiveness considerations?

I Technical innovation and market structure

Our discussion of technical innovation begins with an examination of the conventional dichotomy. Although this requires that we cover a good deal of old material, it seems essential that this matter be put to rest at the outset. We then consider a series of recent refinements to the technical innovation-market structure issue.

(A) THE CONVENTIONAL DICHOTOMY

However complex the subject matter under consideration may appear to be, there is always a possibility that the underlying structure is funda- [illegible]

one's lights, the market structure most conducive to technical progress involves large size and monopoly power or, alternatively, small size and competition – is such an effort. Unfortunately in this instance the attempt must be judged a failure.

1 (i) *The arguments*

We count here as potentially relevant those observations relating market structure to technical progress that have occurred since antitrust first became a social issue. Consider in this connection the statement of Alfred Marshall who, speaking in 1890, expressed the view that differential progressiveness was 'the main reason for regarding with some uneasiness any tendency . . . towards [the] consolidations of business' [32, p. 279] † He went on to observe that while the employment of scientific specialists may occasionally place the large firm at a technical advantage, 'these advantages count for little in the long run in comparison with the superior inventive force of a multitude of small undertakers' [32, p. 280] Arthur Hadley took a similar position in 1897:

> The tendency of monopoly to retard the introduction of industrial improvement is . . . a more serious thing than its tendency to allow unfair rates. This aspect of the matter has hardly received proper attention. We have been so accustomed to think of competition as a regulator of prices that we have lost sight of its equally important function as a stimulus to efficiency. Wherever competition is absent, there is a disposition to rest content with old methods, not to say slack ones. In spite of notable exceptions this is clearly the rule [16, p. 383]

Subsequent developments in competitive theory were, as George Stigler points out, much concerned with the refinement of static efficiency analysis [40, pp. 270–1]. Attention to the progressiveness dimension correspondingly waned. Partly as a reaction to this almost exclusive focus on static resource allocation, and partly as a result of his own interest in economic development, Joseph Schumpeter countered with what might be characterized as the alternative hypothesis. Like Hadley, he took the position that the kind of competition that counts is attributable to 'the new commodity, the new technology, the new source of supply, the new type of organization (the largest-scale unit of control for instance) – competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the

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† Numbers in brackets refer refer to references

firms but at their foundations and their very lives' [38, p. 84]. Unlike Hadley, however, this emphasis on dynamics led Schumpeter to conclude that it is monopoly not competition that is a prerequisite to progress [38, Chap. 8].

Neither Hadley nor Schumpeter was especially precise regarding a specification of the monopolistic condition; Schumpeter was especially ambiguous in this respect. As Stigler notes, Schumpeter regards 'every departure from perfect competition in a stationary economy . . . [as] monopoly, and that is why it is so easy to show that monopoly is necessary to progress' [40, p. 272]. Thus, while restoring attention to the progressiveness dimension in a useful way, Schumpeter left the matter of the optimum organization of industry somewhat unclear.

In what might be characterized as the neo-Schumpeterian position, this structural ambiguity is largely overcome: large size and structural monopoly are said to be most conducive to technical progress. J K Galbraith expresses it as follows:

> . . . a benign Providence . . . has made the modern industry of a *few large firms* an almost perfect instrument for inducing technical change. It is admirably equipped for financing technical development. Its organization provides strong incentives for undertaking development and putting it into effect. . . .
>
> There is no more pleasant fiction than that technical change is the product of the matchless ingenuity of the small man forced by competition to employ his wits to better his neighbor. Unhappily, it is a fiction. Technical development has long since become the preserve of the scientist and the engineer. Most of the cheap and simple inventions have, to put it bluntly, been made [13, p. 91]. (Italics added.)

This view, which has been expressed (both before and since) in a variety of ways (see the citations in [21, pp. 29–31]), has been, in our experience, the prevailing view among undergraduates in the 1960s. One might characterize it as a truth that every schoolboy knows: it may even qualify as the conventional wisdom. But this may be attributable more to the effectiveness of the media ('progress is our most important product', 'better things for better living . . . through chemistry', etc.) than to the soundness of the argument.

In principle, the issue can be addressed in both theoretical and empirical terms, and indeed the literature provides examples of each. Kenneth Arrow's treatment of cost saving innovations is probably the most widely cited example of the former.[1] He shows that the incentive to innovate is greater under competition than under monopoly [1, pp. 619–22]. This assumes, however, that the appropriability of the potential gains attributable to the innovation is not significantly greater under monopoly. Also, Harold Demsetz argues that Arrow's demonstrated incentive differential fails when appropriate standardization techniques are employed [9, pp. 16–19]. F M Scherer's more recent work [35] on the effects of rivalry on R and D (developed mainly in the context of a duopoly model) tends generally to favour the rivalry condition, but even this is qualified and neither he nor we would regard it as conclusive.

Altogether we conclude that the extant theoretical literature leaves the matter of the effect of structure on progressiveness very much open. We turn therefore to an examination of the evidence.

(ii) *The evidence*

We deal here strictly with the matters of how R and D expenditures vary in relation to large size and with the influence of industrial concentration on innovative performance. Large size does not necessarily imply monopoly power, and in this sense might be distinguished from a pure monopoly theory of innovation. There is, however, a tendency for large absolute size to be associated with large relative size, and the neo-Schumpeterian position seems to be that large absolute and relative size,[2] individually and in combination, can be expected to yield greater innovative performance.

(a) Absolute size

Based on data reported by the National Science Foundation, which considers three size classes for firms (below 1,000 employees, 1,000–5,000 employees, and over 5,000 employees), there is a clear tendency for firms in the largest of these three size classes to spend more on R and D as a percentage of sales [28, p. 67]. This is, however, an insufficiently fine basis for classification: virtually all the firms in the *Fortune* 500 largest industrials series had over 5,000 employees in 1968; General Motors numbered its employees at 750,000 in that year. A breakdown within the over 5,000 category is thus indicated if the absolute size question is to be dealt with in policy relevant terms. Daniel Hamberg's investigation of the relation between R and D intensity and firm size among 387 firms selected from the *Fortune* list of the 500 largest industrials in 1960 is useful for this purpose. Taking these corporations as a group and correlating R and D employment/total employment against size measured as total employment, a positive, significant correlation is obtained. When total assets are used to measure size, however, a negative, insignificant result is reported [18, p. 58].

Since interindustry R and D experience differs significantly, even these results are of questionable value to the arguments about technical innovation. Hamberg therefore distributes these firms across seventeen two- and three-digit industry groups. He then investigates the elasticity of R and D employment in relation to size (measured as total employment or total assets in each industry) by obtaining least-squares estimates to the regression equation $Y_{ij} = a_j X_{ij} B_j$ (where the subscripts i, j refer to the firm and industry respectively, Y is R and D employment, X

[1] An earlier treatment is that of William Fellner's [11]. Daniel Usher [43] considers the new product innovation issue, but draws no implications as to the effect of market structure (other than to note that the private incentives are less than the social).

[2] Although relative size is an incomplete measure of market power, it is surely one of the more important structural dimensions. It is, at once, the structural measure most commonly referred to in the literature, the most widely available in the statistics, and the most often addressed by the anti-trust agencies and the courts. Any decisive tendency for either the competitive or the neo-Schumpeterian hypothesis to be supported by the data should, presumably, be detected with a simple concentration ratio characterization of market power. We therefore consider successively the large size and concentration ratio relations.

measures size, and the estimated value of B_i is the relevant elasticity). Elasticity values greater than

significant [18, pp 60–3]. Overall, he concludes, 'a case can be made for the hypothesis that research intensity . . . increases with size among the larger firms in but three industries' [18, p 61].

William Comanor performed a roughly parallel set of tests using a somewhat finer industry classification than Hamberg [8, pp. 640–3]. Among the twenty-one industries in his sample, six had elasticities that exceeded unity (but none were statistically significant) while fifteen had elasticities less than unity (of which

Edwin Mansfield approaches the matter by posing a somewhat different question He examines R and D expenditures (expressed as a percent of sales) of the very largest firms in relation to their large but not

largest firms in these industries spent more on R and D, relative to sales, than did somewhat smaller firms In the petroleum, drug, and glass industries, the largest firms spent significantly less; in the steel industry, they spent less but the difference was not statistically significant' [24, pp 94–95]. Scherer also found that,

research and development activity: . . . bigness may indeed be a stifling factor' [33, p 265]

Roughly, these results are displayed graphically in Figure 1, where R and D intensity is plotted on the ordinate and firm size on the abscissa. Assuming that R and D expenditures experience constant returns to scale, one could, based on the relations shown in

instead be actively resisted

(b) Concentration

Consider now the influence of industrial concentration, expressed generally as a four-firm concentration ratio, on R and D expenditures. Hamberg [17, Ch 4] and Ira Horowitz [20, pp 330–1] report a positive correlation between R and D expenditures and industrial concentration Scherer discovers a much weaker but slightly positive association [31, pp 119–21] J W Kendrick concludes from an examination of Terleckyj' data that there is no significant correlation between productivity changes and industrial con-

while Williamson, using Mansfield's data, finds a negative correlation between the proportion of innovations introduced by the four largest firms and industrial concentration [45] (The last is strictly a small numbers result and allows for productivity as well as expenditure effects)

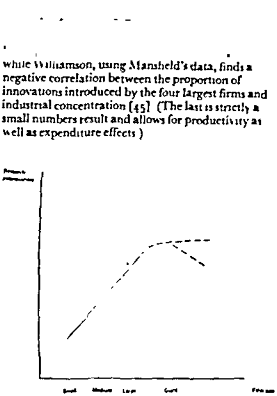

Figure 1

Mansfield's is probably the best balanced view of this matter. He considers diffusion (the rate at which an innovation, once introduced, is adopted by other firms in the industry) as well as the proclivity to innovate. He finds that while greater concentration may be associated with a lower rate of diffusion [24, p. 217], overall—except possibly, for innovations that require a large amount of capital—'there is no statistically significant relationship between an industry's concentration and its estimated rate of technological change' [23, p 245]

We conclude, as did Nelson, Peck, and Kalachek, that the Galbraithian position 'is somewhat exaggera-

does not imply that we embrace the competitive alternative. We reject both. Progressiveness performance is too complex adequately to be characterized by either of these polar extremes Proposed refinements to the technical progress discussion make this particularly evident.

(a) REFINEMENTS

We consider here some of the major qualifications and refinements that have emerged from recent research on the technical progress question. Essentially the argument comes down to this: research and development is not one large, undifferentiated whole. Distinctions with respect to productivity, major versus minor inventions, other market structure dimensions, research intensiveness, basic versus applied research, large, complex versus 'normal'

R and D, and invention versus development would appear to be especially relevant.

It goes without saying that if one picks and chooses among the data that virtually anything can be 'proven'. But however useful conspicuous observations may be as a basis for formulating hypotheses, they provide a hazardous basis for claiming generality. Bell Labs, General Electric and Du Pont may each possess impressive research facilities and personnel, but they do not, apparently, represent average tendencies. (For studies in contrast, consider Western Union and US Steel.) Only a second glance at the statistics is sufficient to dispel any initial impression that the concentration and progressiveness conditions observed in a few glamorous industries are representative [16, pp. 167–73]. The studies reported above reinforce this judgment. Possibly, however, a more refined treatment of the data will be more successful in establishing the case.

(i) *Productivity*

If, over some range, there are scale economies (or diseconomies) associated with R and D, the productivity of R and D will vary with expenditures accordingly. Recall in this connection that while absolute size and absolute R and D spending move together, R and D intensity (expressed as a percentage of sales) is observed to level off, if not turn down, as firm size increases. Possibly this can be explained by scale economies associated with R and D that overcome this expenditure effect: the productivity of R and D programs in very large firms may be greater than are those of their smaller rivals. The evidence, however, though not extensive, does not support this proposition. If productivity can be judged by patents issued per dollar R and D expenditure, the performance of the very largest firms in most industries is somewhat below that of their large but somewhat smaller rivals [34]. Similar results, using a somewhat more refined measure of productivity, albeit for a smaller sample of industries, are reported by Mansfield: 'When the size of R and D expenditures is held constant, increases in the size of firm are [usually] associated with decreases in inventive output' [24, p. 216]. William Comanor found that diseconomies of scale in pharmaceutical industry were encountered at even moderate firm scale [7, p. 190]. The neo-Schumpeterian hypothesis, regarded as a statement of average tendencies, evidently derives little comfort from productivity considerations.

(ii) *Major versus minor inventions*

Just as the productivity of R and D is a relevant distinction, so is the economic importance of inventions. If the importance varies systematically by the source of the invention, the weight to be assigned to the several sources of invention needs appropriately to be adjusted.

Hamberg has set forth and evaluated the hypothesis that large, industrial laboratories are apt to account for a larger proportion of minor than they are of major inventions [17]. As he observes, the hypothesis is not altogether original. Some of the reasons why such a relation might be expected, however, had previously been neglected. Both economic and organizational factors are adduced in favour of the hypothesis.

Basic to the argument is the proposition that major new inventions are usually high risk activities. The large corporation may be structurally and/or constitutionally ill-suited to bear these. But then a firm need not itself be the source of a major, new invention in order to participate in the commercial development of such items: it may be able to buy into successful new developments originated elsewhere—an aspect of the argument developed in Section III below. That it is not especially well-suited to perform high risk inventive research is, necessarily, a comparative rather than an absolute proposition. It relies mainly on the contention that large organizations, business or otherwise, experience debilitating bureaucratic tendencies. Moreover, while claims that the large firm possesses offsetting financial advantages in relation to small firms have merit, the argument requires, at least with respect to high risk activities, certain qualifications.

Hamberg takes the position that: 'The one feature of large business size and monopoly power that appears to carry potential weight is associated with the usually large—absolute—profits of the big monopolistic firms as a source of funds to finance research and innovation' [18, p. 43]. Small firms, perhaps especially successful ones, tend often to find that internal resources are simply inadequate to meet their growing financing needs. These internal financing advantages of large, established firms are apt to be reinforced by their superior access to debt financing. Thus, whereas the established firm has tangible assets and a demonstrated operating capability to offer as security, the small firm requiring research funding has only an uncertain prospect of success to offer. Debt financing for the small firm in these circumstances is not apt even to be feasible. Internal and debt financing do not, however, exhaust the sources of possible funding for inventive activity. The equity capital market, and in particular that part of the equity capital market that we will refer to as venture capital (to emphasize its high risk character) need also to be considered. Here we observe that small enterprises may actually enjoy a structural advantage. Investors in tax brackets for which high-risk capital gains investments are attractive may, because of inability to select among the investment projects in a large firm and appropriate the undiluted gains of risky activities, direct their funds to small, specialized enterprises instead. The financing disadvantages of the small firm may for this reason be less substantial than is often suggested.

The organizational limitations of the large firm as a source of major, new inventions are attributable to its bureaucratic character. We treat this matter more thoroughly in our discussion of 'organizational failure' in Section III below. Here we simply sketch out the argument as it applies to inventive research. It relies in large part on the proposition that 'in the large firm, the team system and an "average man" mentality generally prevail' [17, p. 107]. Hamberg cites in this connection the research views of Daniel

P. Barnard, research coordinator of Standard Oil of Indiana: 'We find the self-directed individual being largely replaced by highly organized team attack in which we employ many people who, if left entirely to their own devices, might not be research-minded In other words, we hire people to be curious as a group. . . . We are undertaking to *create* research capability by the sheer pressure of money' [17, p 107].

Such an approach to research places a high premium on harmony. An emphasis on research results develops which tends to favour support for short-reach [illegible] be driven to locate elsewhere.

[illegible] most commonly undertaken in the large corporation?

Hamberg's survey of the sources of invention makes it evident that major new developments have historically and, although perhaps in somewhat reduced degree, continue presently to come preponderately from sources outside the large corporation. W M Grosvenor, in a study published in 1929, found that only twelve of seventy-two major inventions made since 1889 had originated in industrial laboratories [15]. Jewkes, Sawers, and Stillerman traced the origins of sixty-one major inventions of the twentieth century, most of which occurred between 1930 and 1950 [21]. Of these, twelve could be attributed to the laboratories of large corporations, thirty-three were the work of independent inventors, five were from laboratories of small firms, and the remainder were unclassifiable. Hamberg examined twenty-seven inventions made during the period 1946–55 Seven were the products of large industrial laboratories, twelve were from independent inventors, and the remaining were from small firms, universities, and an agricultural experiment station [17, p. 96], [18, p 16]. Jacob Schmookler's study of patent statistics over the period 1950–7 disclosed that between 50 and 60 per cent of the recent inventions are from inventors working outside the organized research groups of the corporate industrial laboratories [36] Although the relative and possibly absolute importance of the independents has been gradually declining [28, p 57], the base is too large and the rate of decline too slow for the inventive influence of this group to pass quickly to extinction.[3]

The suggestion that the corporation research atmosphere is not calculated to attract eminent scientists also finds support [17, p 108] This is not, as we see it, a particularly surprising or even undesirable result—especially in view of the systems approach to the innovation question that we advance in Section III. It suffices for our purposes here to point out, as a matter of perspective, that industrial scientists in the large corporation are not, typically, 10 feet tall. Again there are occasional exceptions, but here we are looking for average tendencies If smaller firms are able merely to attract competent scientists, they are not in this respect apt seriously to be disadvantaged

Consider finally the research emphasis of industrial laboratories. Nelson, Peck, and Kalachek conclude that 'Outside defense and space-related R and D and possibly some segments of the civilian electronics and chemical industries, the bulk of corporate R and D is modest design improvement work not reaching very far—the type of work that results in yearly changes in automobile design, gradual improvements in the automaticity, speed, and capacity of machine tools, rather than radically new products and processes' [28, p 54] It might not be unfair to characterize industrial R and D as mainly mundane rather than exotic, contrary to the conventional wisdom Indeed the majority of what gets reported as R and D expenditure is concentrated in the production process—including design, engineering, and tooling, as well as manufacturing and marketing startup costs [23, p 106] The Mansfield–Hamburger study cited earlier concludes that 'the bulk of R and D carried out by large corporations is relatively safe and aimed at fairly modest advances in the state of the art' [25, p 66]. Even in a corporation as large and competent as Du Pont, of the major inventions that it implemented between 1920 and 1949, many more, proportionately, of the improvement inventions than of the new product inventions were originated in Du Pont's laboratories [26, pp 342–3]

Although this may appear to relegate the large corporations to a position of secondary importance, this is not intended For one thing, an improvement emphasis by the large firms may represent a rational allocation of resources in a systems sense For another, while there may be a 'good deal of truth' in the improvement hypothesis, 'Technical change in many industries may be due in considerable measure to the cumulative effect of many "improvement" inventions' [24, p 93]. Finally, in some industries and for certain types of research, these average tendencies do not hold—as discussed in Parts 5 and 6 below

That, in principle, the distinction between major and minor inventions is important would be freely conceded by most of those who have been involved in the industrial R and D controversy. That, in most

[3] It has been suggested to us that the relations between large and small firms with respect to major, new inventions is a statistical artifact: The large firm tends to decompose the invention process into a series of stages and, as a result, reports numerous small developments. Cumulatively these are properly considered major developments, but the records fail to report this activity as such.

We are somewhat at a loss as to how adequately to respond to this argument To some extent it may be correct. To the degree that it attempts to restore improvement innovations to a position of importance, we are sympathetic but believe that this can be handled separately (see below). For the most part, however, the procedures employed by Grosvenor, Jewkes, et al., and Hamberg do not appear to be seriously biased in the fashion suggested. These investigators took what were generally recognized to be major inventions and traced their origins. Internal decomposition processes should not seriously influence these results. The same cannot be said, however of Schmookler's treatment of patent statistics. Here the argument has more (potential)

industries, the large industrial research laboratory appears mainly to be a source of improvement inventions and that other sources play so substantial a role in the major new development aspects of research comes as some surprise to many—including the authors. Not that small firms and inventors would be expected to play no role in this activity, but that they are so important is what surprises us. Those who would rest the case for bigness in business mainly on inventive, that is to say patentable, research output would appear to have chosen their weapons badly.

(iii) *Other dimensions of market structure*

With the exception of concentration, the above discussion runs exclusively in terms of absolute size. The focus, thus, is mainly on the bigness rather than the monopoly claims of the neo-Schumpeterian hypothesis. If, however, the latter is also to be addressed, the frame of reference needs to be expanded. Relevant to a judgement of the influence of monopoly on innovation would be the condition of entry and changes in relative shares. These in turn may be influenced by such matters as product differentiation, extent of vertical integration, and the degree to which parallel action is observed.

Although there have been studies that address aspects of these [8], [30], the results have not been wholly conclusive or the welfare implications obvious. Perhaps for the present it is sufficient to rest on the observation that, on the average, concentration does not appear to have a significant influence on innovation and that, in systems sense, an active market in inventions favours progressiveness. The latter is considered further in Sections III and IV.

(iv) *Research intensiveness*

Two questions are raised by the matter of research intensiveness. First, are oligopolistically organized industries more adept at exploiting their technological potential? Second, are there science related industries which, by reason of the opportunities for commercial development afforded by their close connections with a sophisticated external science base, stand apart as exceptions from the general argument? Consider the oligopoly argument first.

Ideally, one would like to test whether there is any systematic relation between market structure and the proclivity of an industry to take advantage of its technological opportunities. This would require that realized achievement be compared with technological potential. Characterizing the latter in a sufficiently precise way to make meaningful comparisons does not, however, appear to be feasible. Nevertheless those who espouse the case for oligopoly on account of its superior progressiveness properties appear to rely in large part on the proposition that oligopoly—by reason of the rich network of interfirm relations among the member firms (in which both offensive and defensive research considerations play a role)—induces more complete exhaustion of an industry's innovative potential. Even if only indirect evidence can be brought to bear on the argument, this presumably would be useful.

If, as seems plausible, the richness of oligopolistic interaction should usually be strongest among the dominant firms in the industry, then oligopolistically induced proclivities to innovate ought to be evident by comparing the relative research performance of the largest firms in less concentrated industries with those with greater concentration. The largest firms in the more concentrated industries ought to perform relatively better. The data, though limited, contradict the argument [45]. For the present at least the proposition is at best unproven and should be regarded as doubtful.

Consider now the possibility that large size by itself may be essential to exploit effectively the innovative opportunities which certain technologically orientated industries offer. As Almarin Phillips has emphasized, where a recognized scientific discipline is related to the technologies and products of existing firms, a complementary R and D activity in the firms is likely [31]. There is, for example, general agreement that the technological opportunities in the chemical and electrical industries are greater than in the mechanically based industries [24, pp. 1100, 1121], [28, pp. 40–3]. Do such industries display quite different innovation in relation to firm size relations than come through from the average tendencies reported earlier?

The matter, unfortunately, has not been extensively studied. Casual references to what is often referred to as the "chemical exception" seem to suggest that certain industries do violate the usual rules, and it will be recalled that Mansfield did find that the largest firms in the chemical industry spent more on R and D, relative to sales, than did somewhat smaller firms [24, p. 94]. Judging from patent statistics, however, Scherer reports that "For both chemicals (with stone, clay, and glass) and electrical equipment, there may be slightly increasing returns up to sales of roughly $500 million, but beyond that point a definite flattening out of the patenting function is evident" [34, p. 110]. What would seem to be required, really, is a series of intensive industry studies of the potentially exceptional cases. Which genuinely display exceptional tendencies, and what are the limits of the argument? Since from a policy standpoint (see Section IV), it is less absolute than relative size that matters, and if, usually, these science-based industries are themselves large, requisite size may easily be reached without posing a significant market power issue.

(v) *Basic versus applied research*

While rarely explicit, the suggestion is often made that much of industrial research, especially that conducted by the larger companies, can appropriately be designated as basic research. In a gross sense at least, this view must be rejected. Industrial R and D in 1961 was predominantly development (78 per cent) and applied research (18 per cent), with basic research accounting for only 4 per cent of the total [28, p. 55]. Although large firms are more apt to sponsor basic research than their smaller rivals, major in-house basic research occurs in only a few industries: 83 per cent was attributable to six industries, with four of these (chemicals, electrical equipment and electronics,

aerospace, and petroleum) accounting for over 70 per cent [28, p. 56]. This raises again the science-based exception question considered above.

Lest the tail wag the dog, one should, presumably, regard arguments that favour bigness on account of differential basic research propensities with caution. [illegible]

The study by Mansfield and Hamburger of the R and D programmes of 22 major firms in the chemical and petroleum industries bears on this matter. They [illegible] the largest firms and firms one-half their size are seldom large, if they exist at all' [25, p. 71].[4] Thus, even in industries which, in a comparative sense, are known to direct a high percentage of R and D expenditures to basic research, giant size does not appear to favour basic research support of unusual proportions

(vi) *Large, complex versus 'normal' R and D*

The romantic notion that the large industrial research laboratory is typically engaged in basic research on major new product developments is frequently buttressed by claims that the imperatives of modern technology are such as to leave little opportunity for any but the very large firms to conduct research on the requisite scale.[5] The argument, apparently, is that the so-called chemical exception is becoming prevailing. Although there may be some tendencies in this direction, these appear to be limited rather than general and, even where observed, are gradual. For those who take the position, as we do, that the near-term future is apt to be a simple extrapolation of the past, there appears to be little reason to expect that the relations reported above will soon be drastically upset.

We nevertheless recognize that there are projects the size and complexity of which require unusual research resources. Examination of military and space R and D suggests that great absolute size may be necessary to support much of this research [28, p. 53] — although a case can be made that some of this bigness is attributable to the choice of inferior research and contracting practices by the military services [22], [46]. If, however, we take the prevailing approach to military R and D as given, great size may be necessary adequately to support military efforts. Private R and D also, occasionally, involves 'complex multi-component systems or complicated chemical processes' for which great size is important [28, p. 53].[6] One should take care, however, lest the argument be inappropriately generalized. Atomic energy and Apollo programs are exotic and con- [illegible] strategy can also be supplied with an underlying contractual rationale [46]. In any event, projects that require a large, complex R and D capability are less common in the private sector and would appear to constitute an identifiable subset — for which exceptions to the main argument may be necessary — rather than the general case (current or prospective)

(vii) *Invention versus development*

The distinction between invention and development in the treatment of innovation will be considered in greater detail in Section III. Suffice it here to point out that while modest resources are frequently sufficient to support invention and even early stage development work [21, pp. 210–12], later stage development often incurs much greater expense. Although giant size is rarely indicated on this account, large size may be. Individuals and small [illegible] already large and possess extensive research laboratories and supporting facilities presumably enjoy an advantage in the later stages. Thus, unless smaller firms can efficiently secure access — on their own or through market processes — to an equivalent capability, they may be deemed to experience serious innovative weaknesses

II Organizational innovation and market structure

Although organizational innovation is scarcely a new concept, it has not received nearly the intensive study that has been given to technical innovation. It is, consequently, rather ill-defined. Broadly it may be taken to be all cost reducing activity that is not attributable to technical developments. This sweeps up a great deal — including refinements in cost accounting, work scheduling, personnel and collective bargaining procedures, etc. — as well as changes in organization form. Our interest here will be restricted to organizational innovations of this last type — where

[4] Lest the argument be interpreted as a strong contradiction to the suggestion advanced earlier that large firms may not be especially well-suited to perform high risk inventive research, note that (1) the firms in the Mansfield-Hamburger study were all established enterprises of at least moderate size, so that the comparison is strictly limited, (2) the results refer to inputs rather than outputs, and (3) the chemical and petroleum industries may, by reason of their science-based nature, qualify for inclusion in the exceptional subset.

[5] *See* the citation to Galbraith in the text above. Also see his [14]; for other similar views, see [21, pp. 29–31]

[6] As Jewkes, Sawers, and Stillerman note, large size is more apt to be an advantage for "empirical" inventions, which are common in the chemical process industries, than for "systematic" inventions, which are conceived as a system and are more characteristic in mechanical engineering [21, pp. 164–65]

[7] For a recent discussion of the task force approach to complex projects illustrated by reference to the Apollo program, see [3]

by organization form changes we refer to changes in the internal structure and control procedures employed by the firm to co-ordinate its activities. Such changes are frequently associated with increases in the breadth and depth of economic activity performed within the firm.

While technical developments are usually regarded with acclaim, organization form changes are apt either to go undetected or, if noticed, to give rise to expressions of dismay. Non-noticeability is partly attributable to the non-patentable character of such innovations. Dismay is registered because these innovations are often regarded as devices for realizing monopoly power. (Although Schumpeter's early work on economic development appeared to suggest that organization form and monopoly were often associated [37, p. 66],[8] the connection between organization form and monopoly is less evident in his later work [38, pp. 84–5]. The impression that such organizational changes are generally designed to secure monopoly advantage has nevertheless persisted.)

It is not our intention to suggest that organization form changes cannot have monopoly consequences, but that this conceives of these organizational developments much too narrowly. Organizational innovation not only can but frequently does have important efficiency attributes. This can be true both of vertical integration and multi-divisionalization.

(A) ORGANIZATION FORM CHANGES DESCRIBED

For many purposes, internal organization and market exchange can be usefully regarded as substitutes. Integration and diversification, viewed in this way, are usually matters of degree: pure cases of firms that are fully integrated or completely specialized, although possibly interesting, generally fall in the null set. That firms are not organized as single function, single product activities is due to the fact that market exchange is either costly or experiences what may be referred to as 'failures'. Partly these may be attributable to the institutional rules of the game, but partly they may be in the very nature of the system.

Vertical integration, for example, may be attractive as a basis for achieving price discrimination, as a device for avoiding transaction costs, or as a means of overcoming incentive problems that the market experiences in handling risk.[9] Although integrating for price discriminating purposes is a means of mobilizing latent monopoly power, vertical integration undertaken for either administrative cost or risk reasons may have strictly efficiency consequences. (This last is discussed more thoroughly in Section III below.)

Multi-divisionalization, by which we mean splitting the firm into a series of quasi-autonomous (nearly independent) operating divisions, can also have important efficiency consequences [49]. In a static sense, these are due to its superior goal formation and control loss[10] characteristics. But multi-divisonalization, especially if it involves diversification, may also facilitate the assignment of cash flows to high yield activities—a dynamic efficiency consideration that is especially important in an economy where the tax laws tend to encourage the internal investment of funds and where the capital market experiences significant frictions. A general lack of appreciation for organizational innovation as an efficiencies generating activity presumably explains prior neglect of these types of consequences.

(B) ORGANIZATIONAL INNOVATION AND MARKET STRUCTURE

Vertical integration, by itself, has no immediate effect on market concentration at any stage. It may, however, as indicated above, be a means of mobilizing latent monopoly power (e.g., by facilitating price discrimination) and can have eventual concentrating effects as well. The latter might obtain, if by foreclosing markets, entry were inhibited to any but a fully integrated supplier, thereby raising capital requirements. Concentration can also result if vertical integration is used against rivals in a predatory manner. At least as often, however, and perhaps usually, vertical integration is more apt to be an efficiencies-directed rather than monopoly-intended undertaking. Indeed, the latter possibility can be dismissed altogether unless integration involves the combination of stages with non-trivial market shares in already concentrated industries.

Although discussions of vertical integration reach far back in economics, multi-divisionalization (at least in the modern sense of the term) is a more recent concept. Du Pont and General Motors introduced the multi-division form in response to internal efficiency problems experienced in the then prevailing unitary form (functionally organized, highly centralized) structure[11] in the early 1920s. Somewhat later, but independently, it was adopted by Standard Oil of New Jersey and Sears. It has been widely imitated and 'rediscovered' since [6].

Given the evident inability of the unitary form organization to deal with large size and complexity, it seems safe to predict that, in the absence of the multi-division form innovation (or some comparable corporate form development), firms that had attained large size would find their growth arrested. Smaller rivals that did not experience as severe co-ordination and control problems would, presumably, have grown relatively.[12] Disseconomies of large scale attributable to control loss experience would in this way have placed a limit on firm size; concentration of production would have been checked.

8 He did not, however, regard the association as unidirectional. Organizational innovations could either create or destroy monopoly.

9 This does not exhaust the possible reasons for vertical integration, but it is sufficient for our purposes here.

10 Control loss refers to the efficiency of internal (hierarchical) administrative processes [47].

11 Actually, General Motors was organized more along the lines of a holding company [6, p. 372]. But the unitary form structure is the one that prevailed in most firms at the time.

12 Thus, while Du Pont was unable in 1919 to make some of its new ventures break even, many of its smaller rivals were prospering [6, p. 112]. Had Du Pont been unable to solve its co-ordination and control problems, a relative decline in its market position could have been expected.

The multi-division form organization, by overcoming many of these control loss conditions, permitted already large firms that adopted this structure to continue their growth—at least absolutely and, for many of them, relatively as well. In classic natural selection fashion, those that adopted the new form and realized the economies which it permitted prospered and acquired resources with which to expand [7, p. 22]. The initial impact of the multi-division structure can thus be judged to have increased industry concentration above what it otherwise would have been.

That its eventual effect has been to increase concentration (expressed in an industry rather than economy-wide basis) is less clear. A related and frequently more important consequence of divisionalization than mere magnification has been that it has facilitated diversification. Thus, although some of the firms that have adopted the multi-division structure have indeed maintained high product specialization ratios, many others have not. Hence, while the overall effect of the multi-division form innovation has been to increase feasible firm size, and in this way has permitted economy-wide concentration to increase, its diversification consequences leave the effect on industry concentration uncertain.

There are, of course, important concentration influencing factors other than organization form to consider [4, Chap. 6]. It is nevertheless interesting to note in this connection that adoption of the multi-division form organization has been particularly common among large firms since World War II [6], and that from 1945 to the present the major concentration increases have occurred on an economy-wide but not on an industry basis [50, pp. 2–3], [4, Chap. 5]. This may be strictly coincidental, but we suspect that progessive adoption of the multi-division structure has been a contributing factor. Of greater relevance for our purposes, however, is the special importance (which, generally, has hitherto been neglected) that organization form analysis has for an understanding of technical innovation.

III A systems approach

Suppose, as a policy matter, that one is instructed to select a programme that will enhance technical progressiveness and that the alternatives are either to encourage or discourage increases in the absolute and relative size of the largest firms in every industry. A brief review of the technical innovation in relation to firm size and industry structure literature yields the following summary observations: R and D expenditures (expressed in relation to firm size) are not usually greater and are often lower for the very largest firms in an industry by comparison with its large but somewhat smaller rivals; the productivity of research expenditures follows roughly the same pattern; industrial R and D is, preponderately, applied in nature, with a few large firms and a few industries offering partial exceptions; research conducted in most large industrial laboratories favours minor improvement inventions rather than major new inventions; the short-reach nature of most industrial research (military and space research and some chemical or other continuous process research constituting principal exceptions) does not require large scale support. If the foregoing review is an accurate assessment of the situation (which assumes that the available studies are unbiased) a preference for the giant size discouragement programme would seem not injudicious.

One might object that the policy options postulated are unnecessarily constrained. We would agree. We have been describing central tendencies, but there are notable exceptions Suppose, arguendo, that [illegible]
our purposes here, let us assume that only gradualist measures are intended, side effects attributable to extreme changes are thereby avoided. A more subtle objection might then be registered: the above review tends to regard the technical innovation question as a matter of optimum firm size, while in fact the innovation process ought to be more broadly conceived.

We believe that there is substantial merit to this viewpoint, although it raises some very difficult questions. To avoid the issue on this account, however, is scarcely satisfactory. We therefore attempt in Part A of this Section to sketch the rudiments of a systems approach to technical innovation Organization form becomes an essential input to the argument. Possible breakdowns in the system (market and organizational failures) are considered in Part B.

(A) A SYSTEMS VIEW

[illegible]
it seems not implausible that a piecewise development by stages is feasible. The tendency in the technical innovation literature to focus on inputs and early stages of the innovation process has perhaps discouraged the development of a broader viewpoint. As Stigler has emphasized, however, invention is merely the first in a series of uncertain stages in the innovation process,[13] and the necessary expertise in bringing the process to completion (which includes not merely invention but also experimental development, market testing, and commercial production and distribution) may differ between stages [40,

[13] A related, but somewhat more extreme view, is that invention is a largely autonomous activity and that the first stage of innovation is the perception of a latent market demand. Once this has been discovered, it is usually possible to find a hitherto unutilized invention that can be made, with appropriate development, to fill the need Although occasionally this may be true, it does not strike us as typical. There is always in some sense a latent 'need', say, for new, low cost materials to be substituted against extant, high cost items. But searching the new materials universe does not, by itself, yield nylon or polyester To the extent, therefore, that the argument has merit, it almost certainly has to be delimited. We will proceed on the assumption that inventions themselves are usually the result of perceived market demands, which makes them an active or integral rather than passive aspect of the innovation process.

pp. 281–2]. The necessary judgement, frequently, is not how to proceed but whether. A critical rejection mechanism for developments that lack essential marketability is needed as well as a capacity to bring feasible projects efficiently to completion.

The innovation process can conveniently, if arbitrarily, be divided into three stages: *invention*, development, and final supply. Corresponding to each is a decision process that may be designated, respectively, as proposal, selection, and a composite process involving co-ordinated production and distribution. Assuming that innovation can meaningfully be decomposed in this way, the question to be addressed is whether, despite decomposability of the process, a single size or form of organization has optimum properties with respect to all stages. Alternatively, is there a transfer process that permits individual firms to specialize according to characteristic strengths and thereby to realize a larger total yield than would be possible were each required to take the process to completion? More generally, are there circumstances in which transfer is both feasible and advantageous but others which favour internal—that is, administrative (intrafirm) rather than market (interfirm)—processes instead?

The frequency with which transfer is observed to occur [18, p. 162], [21, pp. 168, 186], [20, p. 91], [24, p. 58] is, presumably, evidence favourable to the interfirm specialization argument. This raises the possibility that an optimum system need not include among its parts any firms which, when the R and D process is regarded strictly in intrafirm terms (as is common, if not prevailing), would be considered individually optimal. Yet many innovations do not go the transfer process route. This raises the question of what factors explain the co-existence of these two processes.

Among the conventional explanations for internal development are the following: (1) Efficient final supply for many innovations does not require great size; small firms can easily bring these innovations to completion unassisted. Transfer is unnecessary. (2) The need for improvement, especially process improvement, innovations is apt to be more evident to firms that are already engaged in final supply. In many cases these will be the larger firms. To the extent that close co-operation with production and/or marketing personnel facilitates the accomplishment of such innovative activity, large firms will tend naturally to perform research and development on these items in-house. (3) Large firms may be induced for defensive purposes to support some minimum internal R and D effort; reliance on transfer is too risky. Often, it is alleged, these defensive incentives are greatest among large firms in oligopolistic industries.

So much for internal innovation. What explains transfer? If large firms can do everything that small firms can and more, why do any innovations go the transfer process route? Probably the simplest explanation consistent with the argument is that small firms may, occasionally, strictly as a matter of chance, stumble upon an innovation for which they lack the capability to bring to completion. Transfer is dictated on this account.

Although each of these factors may help to explain the observed distribution of innovative activity, they do not clearly exhaust the reasons for internal or transfer processes to operate. Indeed, the reported volume of transfer activity is surely too large to be accounted for so easily, and other reasons can be advanced for expecting innovation to follow the internal development route. Both organizational and market failures need to be examined in these connections.

(B) ORGANIZATIONAL AND MARKET FAILURES

Consider the three stage innovation process described (invention, development, efficient final supply) and isolate the stage at which the greatest size requirements are experienced. Assume, as is usually the case, that efficient final supply is the critical stage for determining minimum efficient scale. Does a firm of requisite final supply size experience any disabilities in attempting itself to perform early stage functions as well?

Approaching the problem in this way focuses on what may be characterized as organizational failures. If these exist, additional reasons to expect the transfer process to operate may be discovered. A symmetrical treatment of these matters would also recognize the possibility of market failures. Are there factors that inhibit the transfer process from operating efficiently? These are the questions that concern us here.

(i) *Organizational failures*

As noted, economies of scale in production and distribution will, frequently, make large (but not often giant) size the preferred structure for efficient final supply. Large size may not, however, be necessary at either of the two earlier stages. The question that we address here is whether there are diseconomies attributable to defective decision-making or incentive processes that operate at the proposal and selection stages. Put differently, what prevents the large firm from replicating everything a series of small firms could perform and more?

The answer, apparently, is that large bureaucracies, of which the large firm is a member, generally experience internal organizational limitations, including a history dependency, which constrain the options available to the organization at any point in time. Among the 'life-cycle' attributes of large organizations noted by Anthony Downs in his study of bureaucracy[14] are the following ageing phenomena [10, pp. 18–20, 96–101]:

1 As bureaux grow older they encounter more situations and develop institutionalized rules for dealing with them on subsequent exposure. Although this may have desirable efficiency consequences in many circumstances, in others it serves to limit the bureau's range of response and, hence, its innovativeness.

[14] Downs is mainly concerned with government bureaucracies, but large organizations of whatever sort can be expected to display the same characteristics, albeit, in the case of the business firm, in somewhat lesser degree.

2 When a bureau is first created it is usually dominated by zealots. Zealots, however, tend not to be good [illegible] by administrators with more conservative orientations.
3 Rapid rates of growth are difficult to sustain as absolute size becomes great. Thus while successful small organizations in which growth is rapid offer numerous opportunities for individual advancement, promotion is less easy in the large bureaucracy. The more enterprising members of the large bureaucracy may thus be induced to locate elsewhere.

These effects are summarized in Down's Law of Increasing Conservatism: 'All organizations tend to [illegible] tends to conform to that postulated by March and Simon in what is sometimes referred to as Gresham's Law of Planning: a preference for programmed activities drives unprogrammed activities out of existence [26, p. 185]. Thus untidy, poorly structured, high-risk activities may not be ones for which the large bureaucracy is constitutionally well-suited to handle.

The limitations of the large firm with respect to the venture capital (see I(B)ii above) might also be mentioned in this respect. Although these limitations may be more than offset by capital access advantages from more conventional sources, the point is that outside venture capital may be specifically earmarked for investment in high-risk inventive activities for which investor appropriability is substantial. Large firms, as usually constituted, are not calculated to attract such sources of funds.[17] In circumstances where, on account perhaps especially of the tax laws, where high variance outcomes are favoured, ceteris paribus, the risk pooling which the large (and particularly the large, diversified) corporation provides can simultaneously impair the investment attractiveness of these firms to venture capital suppliers.

In addition to the reasons given above, which relate mainly to the limitations of the large firm in relation to the proposal process, the large firm may also experience shortcomings with respect to its selection properties. Its error-admission characteristics may be defective. From the standpoint of the career prospects of a bureaucrat, fixed costs are not sunk but need to be justified. Thus the decision to proceed frequently becomes a commitment to succeed, whatever the costs. Sequential decision making procedures [illegible] entrepreneurial reward structure may be defective.

Conceivably the perceptive large firm can attempt to de-bureaucratize[18] itself and overcome certain of these tendencies. Replicating the characteristics of the small firm is not, however, apt to be easy. (The task force approach [5] to projects may have distinct advantages for this purpose, but it is unlikely to be a perfect substitute. Truly entrepreneurial types may find neither the latitude nor the rewards of this approach to innovation sufficient.) In comparison with the costs of going to the market and utilizing the transfer process, intensive efforts at de-bureaucratization are apt to be relatively expensive. If, naturally, organizations experience certain (mainly irreversible) life-cycle changes, it may be more economical simply to acknowledge these and permit specialization by stages to occur rather than force innovation through the internal development route.

(ii) *Market failures*

As indicated in Part A above, there are obvious reasons why the large firm sponsors early stage inventive activity itself. We address ourselves here to the possibility that there are market failures that also contribute to this condition. Several are offered: efficient information exchange, problems of contracting for risky items, market thinness and monopoly powers of scientific personnel.

In principle, the large firm should constitute a superior instrument with which to conduct parallel R and D in comparison with a series of small firms. The reason for this is that it affords an opportunity to realize efficient information exchange and thereby eliminate inferior projects and wasteful duplication at an early point in time [1, p. 356]. Often, however, and perhaps usually, the large firm appears not to be able to support a genuine parallel R and D effort [29, p. 294]. Its planning propensities may preclude this; as James Schlesinger has put it (in a related [illegible] information exchange among independent firms) leave the appropriate market structure uncertain when viewed with respect to parallel R and D.

Stigler has observed that: 'It is only to be expected that, when a new kind of research develops, at first it will be conducted chiefly as an ancillary activity by existing firms. . . . [But eventually] we may expect the rapid expansion of the specialized research laboratory, selling its services generally. These specialized laboratories need not be in the least inferior to "captive" laboratories' [40, p. 281]. But parity in a technical sense does not assure parity in a contractual sense. Assigning R and D to large, private research organizations may, because of inherent task uncertainty, pose risk sharing problems which, [illegible] shortcomings of which have been examined elsewhere.

[17] Possibly new institutional arrangements could be devised to overcome this limitation, but they might impair the performance of the large corporation in other respects.

[18] For a previous suggestion to this effect and a more optimistic estimate of its prospects for success than is given here,

[1, pp. 613–14], [46]. Suffice it to observe that where such problems exist there is no 'clean' systems solution: a cost-plus contract assigns the risk to the sponsoring agency (which may be well-suited to bear it) but undermines least-cost incentives, while a fixed price contract maintains incentives but shifts the risk in what may be an inefficient (high cost) way.

At least occasionally, vertical integration backward into research is the most attractive way to overcome the dilemma posed when high risk programs are to be performed: the sponsoring firm (agency) assumes the risk itself and assigns the task to an internal research group. It essentially writes a cost-plus contract for *internal* development. That this does not have the debilitating incentive consequences that often result when similar contracts are given to outside developers is attributable to differences in the compliance machinery: the internal compliance machinery to which the firm (agency) has access is vastly superior to and more delicately conceived than the policing machinery that prevails between organizations [49, Chap. 9]. Internal organization is thus substituted against the failure of the market in this instance.

Adopting a systems view of innovation makes evident the need to express 'optimum' industry structure not in static but in moving equilibrium terms. Especially important in this regard is that the requisite ease of entry for new product innovators be provided.[17] If the market for innovations is, by reason of high concentration, thin, it may be essential, so as to maintain the bargaining position and hence incentives of the innovators, that internal expansion be a feasible route by which to bring the process to completion. The interests of established firms in preserving secure market positions may, however, sometimes induce them to undertake activities which will impair entry. They may face a tradeoff between the gains of inhibiting entry, so as to increase current profits and maintain their respective market positions, and the advantages of participating (in a systems sense) in new product development. Inasmuch as the latter involves both uncertainty and future rather than immediate returns, established firms may sometimes opt for an entry inhibiting policy. The social interest, however, would appear generally to be served by preserving easy access.[18]

Access difficulties into industries such as automobiles and basic metals illustrate these difficulties. In the former case, refusal by the assemblers to adopt an innovation can, whatever its merits, stand as a bar to acceptance. In the latter, innovations are apt to involve process changes the adoption of which requires incorporation into a continuous process operation. If entry is not a feasible route by which to achieve adoption, and if resistance to change is contemplated, private parties may shrink from supporting as much inventive activity as they otherwise would. Relevant in this connection is Arrow's expressed concern over why patent royalties in the aluminium, petroleum and chemical industries are so low: 'It really calls for some explanation, why the firm that has developed the knowledge cannot demand a greater share of the resulting profits—ideally all except a competitive return on the capital invested' [2, p. 355]. We would suggest that entry difficulties in conjunction with market thinness provides a partial explanation for this condition. System failure of this sort naturally shifts more of the burden of conducting research on to the large established firms which, for reasons given earlier, may be constitutionally less well suited to perform inventive activity.

Consider finally the possibility that certain high talent, scientific personnel possess a degree of monopoly power in bargaining over their employment conditions. They may insist, as part of the inducements-contribution package (where this is used in the sense of March and Simon [26, pp. 83–93]) that some fraction of their time be available for 'undirected' research activity. Although usually, we suspect, such stipulations rarely have substantive consequences, occasionally they may. As a result, the large firm may find itself originating projects that it would otherwise leave for others to develop

None of this is to deny that the prospect of appropriating the monopoly gains associated with a patentable invention provides an incentive for firms of any size to sponsor early stage R and D. Presumably, however, the risk adjusted rates of return to R and D are brought into correspondence at the margin with other types of investments, and the question is what firms in what market circumstances enjoy a relative advantage and why. An evaluation of market failures on the one hand and organizational failures on the other is necessary for this purpose.

(C) AN OVERVIEW

The foregoing argument suggests the following hypothesis: an efficient procedure by which to introduce new products is for the initial development and market testing to be performed by independent inventors and small firms (perhaps new entrants) in an industry, the successful developments then to be acquired, possibly through licensing or merger, for subsequent marketing by a large multi-division enterprise. This is not to suggest that this is the only efficient process. As indicated above (perhaps especially with respect to improvement innovations) there are others; also, market failures may inhibit the operation of the transfer process. It is sufficient for our purposes that transfer be recognized as a common and, from an anti-trust standpoint, often an attractive way for innovation to proceed.

The argument is a simple extension of classical specialization arguments to include technical progress within the framework of systems analysis. In consideration of the disabilities that different forms of organization experience at different stages of the innovation process, and in view of the empirical results regarding research proclivities of large firms in

17 One could argue that easy entry impairs appropriability, but we would maintain the patent system to preserve incentives for this purpose. (As Jewkes, Sawers and Stillerman observe, 'So long as the survival of the individual inventor is not utterly despaired of... and so long as nothing better can be suggested for the purpose, there is a very strong case for the retention of the patent system' [21, p. 251].) Also, taking a systems view rather than a firm view of the innovation process tends to provide a different perspective of the 'need' for entry barriers to support research. We are inclined to regard such arguments as self-serving.

18 For a somewhat similar appraisal, see [28, pp. 71–2].

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This does not exhaust the possibilities, however. Conceivably there will be instances in which firms of minimum size necessary for scale economies in production and distribution will be too small for effective R and D. Much of agriculture falls in this category; a few industries in manufacturing (e.g. cotton textiles and bituminous coal mining) qualify as well. What if a series of mergers between firms were proposed that would bring them up to a size that would support an effective organized research activity but would also offend the Merger Guidelines? As the Guidelines read now, a defence based on R and D economies would be disallowed, unless there are 'exceptional circumstances'. Some may consider this to be a serious weakness in the Guidelines, and would urge formal recognition of an R and D economies defence. Rather than proposing an immediate general exception, however, we would suggest a gradualistic approach and rest on the five following observations:

1 The transfer of technology occurs by an inter-industry as well as an intra-industry process, and equipment and other suppliers may well have a comparative advantage in R and D.
2 A relatively relaxed position on joint research undertakings should help to attenuate any disadvantages attributable to the Guidelines.
3 Potential diseconomies of large scale may offset potential R and D economies, and these as well as market power effects need to be recognized.
4 The importance of an R and D economies defence is presently unknown. It is premature drastically to alter the Guidelines until its quantitative significance is better established.
5 Even assuming that the quantitative significance attributable to potential R and D economies in some industries is substantial, which we find doubtful, only selective rather than general revisions in the Guidelines would be warranted in this account.

There is a further point. As we noted, inventive activity on major new developments is not in most instances an area in which very large firms enjoy a comparative advantage. Consequently, it is important to innovation to preserve and promote a transfer process that permits individual firms to specialize in their particular strengths; more particularly a process that encourages small firms to conduct the kind of innovative activity for which they are better equipped by facilitating profitable transfer of their new developments, in appropriate cases, to large firms better equipped for production and distribution. In what respects, if any, does consideration of the transfer process cause one to qualify horizontal merger rules that otherwise seem sound? This is not a matter that lends itself to an unambiguous answer. To prohibit large firms from acquiring small but incipient rivals altogether could be judged to impair incentives for future inventors to invest resources in this market. If, however, established firms are permitted routinely to snap up incipient rivals, a concentrated, which is to say thin, market in innovations will obtain; this has monopsonistic consequences which impair incentives, to say nothing of the other adverse effects of high market concentration. The arguments do not [illegible] supply, we would not expect the transfer process to be significantly impaired if horizontal merger guidelines were to be enforced as they read presently, nor would we expect a substantial loosening of the rules to achieve overall net gains. The burden of proof, we believe, falls on those who would claim otherwise.

(ii) *Vertical mergers*

As with horizontal mergers, current American enforcement policy is mainly structure-orientated. For a brief summary of the economic rationale, we quote from the Justice Department's Merger Guidelines:

> In general, the Department believes that anti-competitive consequences can be expected to occur whenever a particular vertical acquisition, or series of acquisitions, by one or more of the firms in a supplying or purchasing market, tends significantly to raise barriers to entry in either market or to disadvantage existing non-integrated or partly integrated firms in either market in ways unrelated to economic efficiency.

The principal questions that we wish to address [illegible] of this argument? (3) What are the implications for enforcement of the vertical merger guidelines?

Our answer to the first is that, in consideration of the difficulties associated with outside contracting for large, high risk projects, backward integration into basic research may sometimes be indicated. Also, in consideration of the cumulative importance of improvement and process innovations, which are often facilitated if production engineers work hand in glove with research scientists, producers may want to develop an applied research capability. One is not compelled, however, on account of either of these factors, to go to a fully integrated operation. If this is warranted, its justification lies in organizational rather than technical efficiency factors.

To illustrate, consider the problem of supplying telephone service. Clearly the service parts of this industry may want to support a certain amount of basic research so as to remain current with recent developments and to be able to anticipate future developments in communication technology. The

occasional rare circumstance where a research venture promising expected net social benefits would not (because of risk or non-appropriability characteristics) be undertaken by individual firms, it may be conducted as a joint venture. Although this raises special problems of its own (both for the parties and anti-trust enforcement agencies), we would ordinarily prefer such an arrangement over full integration among the firms in question. For one thing, effective competition in production and distribution can better be preserved in this way. Also, other research projects for which pooling is not required can continue to be performed independently, with the beneficial consequences generally associated with such independent efforts.

As an alternative to joint ventures, the scale requirements of unusually large or specialized R and D programmes might be met by contracting the programme out to specialized laboratories. Indeed, specialized research organizations presumably find primary support for their services in this way. Occasionally, however, this may be inhibited by market failures of the riskiness or market thinness type—both of which are discussed further below.

(B) MERGERS

A systems analysis of the innovation process ('proposal', 'selection' and final supply) tends to suggest that any anti-merger policy should leave considerable latitude for the acquisition of successful developments by large, established multi-divisional enterprises capable of prompt and efficient production and distribution. The transfer process described relies on the existence of a strong market for the acquisition or licensing of successful developments, and possibly for the acquisition of small, innovating firms themselves. Added economic incentives for the pursuit of inventive activity result.

There is no necessary inconsistency between these points and the basic purpose of an anti-merger policy, which is to prevent the growth of undue market concentration, i.e. market concentration beyond what is compelled by economies of scale. However, a variety of reasons suggest that in the practical implementation of an anti-merger policy, some compromises of conflicting considerations will have to be made.

(i) *Horizontal mergers*

Current American rules on horizontal mergers are almost entirely structure-oriented. Whether or not enforcement action will be taken depends primarily on the relative sizes of the merging firms, i.e. on their shares of the relevant market or markets in which they compete. The percentages are not large—a merger of two firms each with 5 per cent of the market is presumed to be unlawful. The larger the size of one of the firms, the smaller the size of the competitor it will be permitted to merge with. If there has been a significant trend toward increased concentration in the affected market, the permissible size limits are lower.

Exception is made for the acquisition of a 'failing company', but that term is narrowly defined and even when a firm so qualifies it cannot sell out to a leading competitor if other buyers can be found. Unless there are 'exceptional circumstances', the Justice Department will not consider an efficiencies defence, the stated reasons being that '(i) the Department's adherence to the standards will usually result in no challenge being made to mergers of the kind most likely to involve companies operating significantly below the size necessary to achieve significant economies of scale, (ii) where substantial economies are potentially available to a firm, they can normally be realized through internal expansion, and (iii) there usually are severe difficulties in accurately establishing the existence and magnitude of economies claimed for a merger'.

The latter point is undoubtedly correct, but the guidelines are rather severe, and it is a fair question whether they do in fact pay appropriate regard to considerations of efficiency. Full consideration of that issue cannot be undertaken here, and it is not necessary that we reach any conclusions. Nevertheless, it would be useful, before considering whether any given rules need be modified in light of R and D considerations, to indicate some reasons why the current American rules on horizontal mergers may well not seriously interfere with the promotion of efficiencies. First, there appear to be few established industries in the American manufacturing sector in which the minimum efficient size of firm for production and distribution is as much as 5 per cent of the industry's output [4, Chap. 6]. If true, prohibiting mergers of two 5 per cent firms in American markets will not often raise a substantial efficiency issue, assuming—and this is a critical assumption—that markets are defined in an economically sensible manner. Interference with acquisitions of 3, 2 or 1 per cent firms by firms with 10, 15, 20 or higher market shares is more likely to involve firms inefficiently small, but the latter remain free to merge with less sizeable acquirers, and it is highly unlikely that the efficiency of a firm with 10 per cent or more of an established market would be substantially improved by acquiring a firm of 3 per cent or less.

Moreover, firms of a size substantially below that necessary for economies of scale are likely to be classifiable as 'failing companies', provided that the enforcement agencies and courts in practice depart somewhat from strict adherence to the prolongated test. Any serious size disadvantage should normally reflect itself in the kind of declining market share and financial loss that would absolve mergers otherwise prohibited. Where small firms have been able to maintain their market position and earn satisfactory profits, one would suppose that in most instances either (1) they do not in fact suffer from efficiency disadvantages, (2) they have some offsetting competitive advantages, or at least a corner of the market in which they play an effective competitive role, or (3) price umbrella practices prevail.

Finally, even where substantial economies in production and distribution might be realizable through merger of firms in the prohibited range, these can often be obtained, though perhaps not as quickly, by internal expansion or by merger with other than substantial direct competitors.

This brings us to our primary question, whether

horizontal merger guidelines—as presently conceived or as modified to pay somewhat more regard to efficiencies in production and distribution—would need to be substantially revised in light of economies associated with R and D. Broadly speaking, our conclusion is negative. Our reading of the evidence agrees with that of the leading specialists in this area. Conventional wisdom to the contrary notwithstanding, giant absolute and/or relative size are not typically necessary to support an effective R and D effort. Indeed, although large industrial research laboratories have access to certain advantages, this does not cut across the board. Inventive activity on major new developments is not, in most instances, an area in which the large industrial research laboratory enjoys a comparative advantage.

This does not exhaust the possibilities, however. Conceivably there will be instances in which firms of minimum size necessary for scale economies in production and distribution will be too small for effective R and D. Much of agriculture falls in this category; a few industries in manufacturing (e.g. cotton textiles and bituminous coal mining) qualify as well. What if a series of mergers between firms were proposed that would bring them up to a size that would support an effective organized research activity but would also offend the Merger Guidelines? As the Guidelines read now, a defence based on R and D economies would be disallowed, unless there are 'exceptional circumstances'. Some may consider this to be a serious weakness in the Guidelines, and would urge formal recognition of an R and D economies defence. Rather than proposing an immediate general exception, however, we would suggest a gradualistic approach and rest on the five following observations:

1 The transfer of technology occurs by an inter-industry as well as an intra-industry process, and equipment and other suppliers may well have a comparative advantage in R and D.
2 A relatively relaxed position on joint research undertakings should help to attenuate any disadvantages attributable to the Guidelines.
3 Potential diseconomies of large scale may offset potential R and D economies, and these as well as market power effects need to be recognized.
4 The importance of an R and D economies defence is presently unknown. It is premature drastically to alter the Guidelines until its quantitative significance is better established.
5 Even assuming that the quantitative significance attributable to potential R and D economies in some industries is substantial, which we find doubtful, only selective rather than general revisions in the Guidelines would be warranted in this account.

There is a further point. As we noted, inventive activity on major new developments is not in most instances an area in which very large firms enjoy a comparative advantage. Consequently, it is important to innovation to preserve and promote a transfer process that permits individual firms to specialize in their particular strengths; more particularly a process that encourages small firms to conduct the kind of innovative activity for which they are better equipped by facilitating profitable transfer of their new developments, in appropriate cases, to large firms better equipped for production and distribution. I what respects, if any, does consideration of the transfer process cause one to qualify horizontal mer rules that otherwise seem sound? This is not a matte that lends itself to an unambiguous answer. To prohibit large firms from acquiring small but incipient rivals altogether could be judged to impair incentives for future inventors to invest resources in this market. If, however, established firms are permitted routinely to snap up incipient rivals, a concentrated, which is to say thin, market in innovations will obtain; this has monopsonistic consequences which impair incentives, to say nothing of the other adverse effects o high market concentration. The arguments do not net out in any obvious or easy way. Inasmuch, however, as licensing is usually a meaningful alternative for accomplishing the transfer of technology, and since acquisition by an established conglomerate may afford many of the scale advantages of efficient final supply, we would not expect the transfer process to be significantly impaired if horizontal merger guidelines were to be enforced as they read presently, nor we expect a substantial loosening of the rules to achieve overall net gains. The burden of proof, believe, falls on those who would claim otherwise

(ii) *Vertical mergers*

As with horizontal mergers, current American enforcement policy is mainly structure-orientated. a brief summary of the economic rationale, we quote from the Justice Department's Merger Guidelines

> In general, the Department believes that anti-competitive consequences can be expected to occur whenever a particular vertical acquisition, or series of acquisitions, by one or more of the firms in a supplying or purchasing market, tends significantly to raise barriers to entry in either market or to disadvantage existing non-integrated or partly integrated firms in either market in ways unrelated to economic efficiency

The principal questions that we wish to address here are: (1) are there compelling reasons why backward integration might be warranted on account of research considerations? (2) If so, what are the limits of this argument? (3) What are the implications for enforcement of the vertical merger guidelines?

Our answer to the first is that, in consideration of the difficulties associated with outside contracting for large, high risk projects, backward integration into basic research may sometimes be indicated. Also, in consideration of the cumulative importance of improvement and process innovations, which are often facilitated if production engineers work hand in glove with research scientists, producers may want to develop an applied research capability. One is not compelled, however, on account of either of these factors, to go to a fully integrated operation. If this is warranted, its justification lies in organizational rather than technical efficiency factors.

To illustrate, consider the problem of supplying telephone service. Clearly the service parts of this industry may want to support a certain amount of basic research so as to remain current with recent developments and to be able to anticipate future developments in communication technology. The

service companies would also, presumably, sponsor applied research directed at reducing installation, maintenance and related operating expenses. Firms that supply the service companies with equipment have equally good reasons to support basic and applied research as it bears on their phase of operations. One does not, however, readily justify a vertical connection between service companies and equipment supply on these grounds.

Indeed, if this industry were to satisfy natural monopoly conditions at, say, the service level, backward integration (by merger or otherwise) into equipment in sufficient degree to monopolize equipment supply could be judged to have potentially debilitating innovative consequences. Both the diversity in approach and the competitive necessity that typically characterize a vital innovative effort are apt to be attenuated—manifestations of organizational failure as discussed in Section III.

To the extent that co-ordinated research is advantageous to the discovery of new and more economical production processes or improved products, this can often be accomplished by the pooling of sequentially related functions and expertise. But vertical merger of successive stages is not necessary to co-ordinated research; this can be, and commonly is, effected by contractual arrangements or incorporated joint ventures. We would not claim that these alternatives are always perfect substitutes for full integration under common ownership. Independent co-venturers may have conflicting economic interests that could adversely interfere with the conduct of R and D. But such conflicts may also have beneficial side effects: a closer examination of research proposals and of selection than would be made in an integrated concern may obtain, and hence a more efficient allocation of resources. In sum, while the issue is obviously speculative, we do not believe there is any general superiority of full integration over joint ventures that would dictate a significant loosening of vertical merger prohibitions that otherwise make sense. More generally, if a vertical connection that offends the Merger Guidelines is to be proposed, its justification, if there is one, will ordinarily rest on other than innovative performance grounds.

(iii) *Conglomerate mergers*

Our systems analysis of the technical and organizational innovation processes—indicating that small new firms may often be superior vehicles for the invention and development stages, but inferior in 'final supply'—suggests that anti-merger policy give due latitude to acquisitions of successful developments by large, multi-division enterprises capable of expeditious and efficient marshalling of the necessary production and distribution resources.

As we also noted, however, there is a strong interest in channelling such acquisitions so as to minimize adverse effect on market concentration, or, where possible, so as to make a positive contribution to lower market concentration. This means that anti-merger policy show a preference for some large buyers over others, and generally speaking, preference should be for the 'conglomerate' over the horizontal or 'near-horizontal' acquirer. If rules on horizontal mergers are to remain harsh, it becomes critical that prohibitions on conglomerate acquisitions not be unduly expanded.

Two of the principal current issues in American enforcement policy—the extent to which conglomerate mergers between large companies, or between large companies and 'leading firms' in other markets, should be prohibited—may be set aside as largely irrelevant to our present discussion, which concerns acquisition by large companies of new developments either by acquiring access to the innovations themselves or by acquiring the relatively small firms that have originated them.

What is more directly involved is that part of current policy that seeks to impose limitations on acquisitions by what may be styled as 'leading potential competitors'. The rules contained in the current Merger Guidelines do not seem to pose any serious problem for the kind of acquisition we are discussing. 'One of the most likely entrants' into a market cannot acquire:

(i) any firm with approximately 25 per cent or more of the market;
(ii) one of the two largest firms in a market in which the shares of the two largest firms amount to approximately 50 per cent or more;
(iii) one of the four largest firms in a market in which the shares of the eight largest firms amount to approximately 75 per cent or more, provided the merging firm's share of the market amounts to approximately 10 per cent or more; or
(iv) one of the eight largest firms in a market in which the shares of these firms amount to approximately 75 per cent or more, provided either (A) the merging firm's share of the market is not insubstantial and there are no more than one or two likely entrants into the market, or (B) the merging firm is a rapidly growing firm.

These rules would not seem applicable to the acquisition of a new development or a relatively new small firm, except in rare instances. Moreover, the Guidelines explicitly indicate a more lenient definition of a 'failing company' in 'marginal' cases under rules (iii) and (iv).

The main possible danger is this: the Department may endeavour to expand the scope of its rules by making a qualitative assessment of the prospects of the acquired firm, projecting a 'probable' market share that would bring the acquisition within the challengeable zone. That this is by no means unlikely is indicated by the fact that the horizontal merger guidelines indicate probable suit against 'a merger involving a substantial firm and a firm which, despite an insubstantial market share, possesses an unusual competitive potential or has an asset that confers an unusual competitive advantage (for example, the acquisition by a leading firm of a newcomer having a patent on a significantly improved product or production process)'.

We might not be greatly concerned about an incorporation of this approach into conglomerate merger rules if it were strictly confined to cases in which the acquiring firm appeared to be the only likely entrant into the market concerned, or perhaps (though this is doubtful), one of the only two or three likely entrants. But up till now, at least, the problem of establishing that a company is or is not 'the most

likely entrant' or 'one of the most likely entrants' has proved to be peculiarly frustrating, and there will be *heavy pressures toward resolving it by expanding the number of firms that will be treated as the 'most likely' entrants* and that, accordingly, cannot make the specified kinds of acquisition.

Whatever merit that expansion may have in other

ments of small firms. Moreover, much more often than not in our opinion, it would forestall acquisitions that would substantially improve the market structure and performance of the concentrated markets with which the conglomerate merger rules are properly concerned.

We have, necessarily, been talking in somewhat general terms. We do not mean to suggest that there may never be special instances in which a new firm has come up with an innovation of such merit, and its prospects are so bright, that it may be preferable to keep it out of the hands of any of several large companies that are quite likely new entrants. But we believe those cases will be rare, and that the general presumption should be to the contrary.

(c) JOINT VENTURES

It is manifest from our discussion that we have viewed joint research ventures with more favour than full merger of the parties concerned. One obvious reason is that a joint research venture is less restrictive, actually or potentially, of competition generally in *the markets concerned than full merger would be.*

A second reason is that minimum size for efficient R and D is extraordinarily difficult to determine in almost all cases, and is probably impossible in many. It might be argued for this reason that, in the absence

holding open the possibility for joint research ventures introduces a desirable element of flexibility into the guidelines. Unless the guidelines were to be relaxed in other respects—which, incidentally, a more effective deconcentration policy would permit if not suggest [43, pp. 1213–14]—this flexibility should be preserved.

This does not mean that joint ventures are a matter of no concern. As we have said, it seems certain that competition is as desirable in research as in production and distribution. It would be an extremely rare case where research could be more efficiently conducted in a single entity. Well short of this, one would view with suspicion the creation of a joint research venture by leading competitors who have evidently had the capacity to carry on substantial R and D activities independently. Moreover, even if joint ventures among competing companies with a high proportion of their market, or between vertically related companies that are leading firms in their respective fields, can be justified on efficiency grounds, it may often be appropriate to insist that competitors of the joint venturers be given access to any new developments on reasonable terms.

We shall not try to elaborate these points or draft specific guidelines. The principal policy conclusion is that joint research ventures should be given considerably wider latitude than full mergers—horizontal, vertical or conglomerate—of the participating companies would deserve.

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3.3 Size of firm, R and D, and innovation

C Freeman

1 Size of firm and expenditure on R and D

Whereas fifteen years ago there was very little firm empirical evidence outside the USA on the degree of concentration in performance of industrial research and experimental development, there is now fairly conclusive evidence on this point for the OECD area. As a result of the efforts of the OECD in standardizing definitions and methods, we now have reasonably comparable data for a dozen countries. The picture which emerges is consistent and confirms the hypothesis of those economists who had postulated a high degree of concentration. The hundred largest R and D programmes account for more than two-thirds of all industrial R and D in all countries except one and for more than three-quarters in most cases. The forty largest programmes account for more than half of all [illegible] the five largest programmes account for two-thirds of all expenditures.

There is less complete but fairly conclusive evidence that the vast majority of small firms in OECD countries do not perform any organized research and development.[1]

It is true that the official statistics of research and experimental development expenditures may not capture research or inventive work which is performed by managers, engineers or other staff incidentally to their main work. It may be that this part-time amateur inventive work is exceptionally productive, and the evidence will be discussed for the view that small firms account for a high proportion of significant inventions and innovations. But so far as specialized professional R and D activity is concerned, there is pretty firm evidence that this is highly concentrated in large firms in all countries for which statistics are available.

The OECD statistics (Table I) measure the degree of concentration by *size of R and D programme*, and not by size of firm in terms of total employment, turnover or assets. However, for the major countries some statistics are available on concentration by size of firm, although not as a consistent classification. Firms with more than 5,000 employees account for 88 per cent of all industrial R and D expenditures in the [illegible] Britain suggested that firms with more than 10,000

Table I

Percentage of total industrial R & D performed in firms ranked by size of R & D programmes

	4 *Largest firms*	8 *Largest firms*	20 *Largest firms*	40 *Largest firms*	100 *Largest firms*	200 *Largest firms*	300 *Largest firms*
USA	22·0	35·0	57·0	70·0	82·0	89·0	92·0
UK	25·6	34·0	47·2	57·9	69·5	75·0	77·0
France	20·9	30·5	47·7	63·4	81·0	91·2	93·6
Japan	—	—	—	47·7[a]	52·1[b]	63·1[c]	71·4[d]
Italy	46·4	56·3	70·4	81·6	92·5	—	—
Canada[f]	30·3	40·8	58·4	71·5	86·2	93·2	—
Netherlands	64·4[e]	—	—	—	—	—	—
Sweden	33·2	43·0	54·0	71·0	85·4	90·0	—
Belgium	38·5	51·8	72·6	82·7	92·8	97·5	99·4
Norway	29·5	38·8	55·7	70·6	88·2	97·9	100·0
Spain	25·2	47·0	73·9	91·5	—	—	—

[a] The first 54 firms. [b] The first 85 firms. [c] The first 180 firms. [d] The first 289 firms. [e] The first 5 firms. [f] Current intramural expenditure.

Source: The overall level and structure of R & D efforts in OECD member countries, OECD, Paris, 1967.

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[1] National R and D statistics for OECD member countries.

[2] NSF, *Research and development in industry* (Table 3), 68–70, Washington.

[3] *Wirtschaft und Wissenschaft*, May 1969 (Table 5).

[4] DGRST, *Les moyens consacrés à la recherche et au développement dans l'industrie française en 1966*, Paris, 1968.

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employees accounted for nearly 60 per cent of industrial R and D.[5]

However, the degree of concentration is much less marked by size of firm (classified by total employment) than by size of R and D programme. In the United States there were 470 firms with more than 5,000 employees performing R and D in 1966.[6] But many of them had relatively small R and D programmes, whilst some medium-sized firms (100–4,999 employees) had rather large ones. Thus the 200 largest programmes were approximately equivalent to the outlays of the 470 largest *firms*, each accounting for nearly 90 per cent of the total. In France the 200 largest *programmes* accounted for about 91 per cent of total expenditures, but the 200 largest *firms* (measured by employment) accounted for about 72 per cent.[7]

The major source of variations in research-*intensity* between firms is the *industry* concerned, so that analysis of the relationship with size is best done industry by industry.

If the vast number of small firms who perform no R and D are excluded, then the correlation between research-*intensity* and size of firm is a relatively weak one in most industries, and in some cases it is apparently inverse,[8] despite the very high concentration of R and D in large firms. This is an important observation as it helps to understand more clearly the role of small firms in industrial invention and innovation, and it may also throw some light on the behaviour of firms under conditions of oligopoly and monopoly.

It could be postulated that the few small firms and many of the medium-sized firms who *do* perform R and D would tend to fall into three categories.

1 Firms which have just begun to develop or exploit a new invention. In this case sales could be expected to be relatively low in relation to R and D and a very high research-intensity could be expected.
2 Highly specialized firms which have a particular expertise, sustained by an intensive research programme in a very narrow field. Here too, research-intensity might often be high.
3 Firms struggling to survive in industries in which new product competition makes R and D increasingly necessary. A very varied management response might be expected in these circumstances, with some firms trying to scrape by with a sub-threshold R and D effort, others relying mainly on co-operative research, and still others taking high risks with an ambitious programme.

If these suppositions are correct, they would account both for the relatively weak general correlation between research-intensity and size of firm, and for the empirical observations of wide inter-industry variations in the strength of this correlation. In the UK, France and the USA it has been found that in a few industries, small or medium-sized firms had higher research-intensity than large firms.[9] Even for all industries taken together, although the United States figures show a consistently higher research-intensity for firms employing more than 5,000, it is the Federal contracts placed with firms that account for the greater part of the difference (Table II). Taking

Table II

Funds for R & D as a percentage of net sales in R & D performing companies, by size of company, USA

Firm size	*Total R & D including Federal contracts*			*Company funds for R & D*		
	1958	1964	1966	1958	1964	1966
Less than 1,000	1·3	2·4	1·7	0·7	1·4	1·4
1,000 to 4,999	1·8	1·8	2·0	1·3	1·6	1·2
5,000 or more	4·8	5·3	4·9	1·9	2·1	2·0

Source: NSF 68–20, Tables 58 and 59.

company-financed R and D only, the difference by size of firm is not great, (remembering that we are dealing here only with those firms that *do* perform R and D). The very small difference between the aggregate ratios of small and medium-sized firms is also striking. The fact that in some years the ratio was actually higher for small firms suggests that the aggregate figures may be surprisingly sensitive to changes in size classification of a few firms with large programmes, or to cancellation of such programmes.

Turning to variations in research-intensity among *large* firms, Hamberg[10] and Scherer[11] found only a weak correlation with size measured in terms of employment or sales, and still less with size measured in terms of assets. Hamberg's sample consisted of 340 large firms from the *Fortune* 500 list (1961), while Scherer's sample was 448 firms from the same list (1955). Scherer made the interesting observation that in several industries, research-intensity generally rose with size up to sales of $250 million, but turned down somewhere between $200 million and $600 million. However, in chemicals, motors and steel this was not the case.[12] It might be postulated that the 'humped' distribution noted by Scherer in some industries was related to the degree of monopoly power and Moring has found additional European evidence to support this hypothesis.[13] Moring's tentative explanation of the 'humped' distribution is that oligopoly provides a stronger incentive to coporate R and D performance than either small-firm competition or monopoly, because of the higher degree of uncertainty under conditions of oligopoly. However the high research-intensity of some very large US and European firms in telecommunications, automobiles and chemicals makes generalization hazardous.

5 FBI, *Industrial research in manufacturing industry*, 1961.
6 NSF, op. cit., n. 2.
7 DGRST, op. cit., n. 4; OECD, *The overall level and structure of R & D in member countries* (Table 4, p. 46), Paris, 1967.
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13 G Moring, *Market Structure, Uncertainty and R & D*, SPRU, University of Sussex, 1968.

Thus, summing up the evidence on size of firm and R and D expenditures:

[illegible]

degree of concentration is significantly less by size of firm than by size of programme.

3 The vast majority of small firms (probably over 90 per cent) do not perform any specialized R and D programmes.

4 Among those firms which *do* perform R and D, there is a significant correlation between size of total employment and size of R and D programme in most industries.

5 There is a much weaker correlation between the *relative* measure of research activity (research-intensity) and size of firm and it is not significant in many industries. In a few industries in both Europe and USA, smaller firms show higher research-intensities.

6 Among the *larger* firms there is also evidence that in some industries research-intensity diminishes with size above a certain level, and there are few industries with a significant correlation between size and research-intensity.

Before attempting to interpret these results it is necessary to consider the relationships between R and D expenditures (inputs into R and D) and R and D 'output'.

2 Size of firm and innovative success

A number of economists have maintained that, despite the heavy concentration of R and D expenditures in large firms, it is the small firms which account for most of the important inventions and innovations. If true, this might be accounted for in several different ways. The most obvious explanation would be a major difference in efficiency of R and D performance

[illegible]

grammes of large and small firms are directed towards somewhat different objectives. A third possible explanation could be that external economies are extremely important in the R and D system and that

[illegible]

conduct of R and D itself, suppress the results for monopolistic reasons and consequently score badly on *innovation*.

[illegible]

It is generally accepted that the *direct* output of industrial R and D is a flow of information relating to new and improved products and processes. This may take the form of research reports, technical specifications, operational data and instruction manuals based

[illegible]

this flow to a common denominator which could be used for inter-firm or inter-industry comparison. The

[illegible]

statistics, and ingenious attempts have been made to use these for various forms of comparison, including relative inventive output by size of firm.[15] However, they are unsatisfactory for a variety of reasons, of which the main one is that firms and industries vary considerably in their 'propensity to patent'. Some firms attach great importance to patents and have large departments with a strong interest in patenting activity, which will tend to 'inflate' their inventive output when measured in this way. Other firms either do not want to bother with patents or prefer to rely on secrecy. There has been a tendency to assume that large firms would have a higher 'propensity to patent' than small firms and that consequently a measure of output of R and D based on patent statistics would understate the contribution of small firms. Since, in the United States, small firms show a much higher number of patents per $ of R and D expenditure than large firms,[16] this has been claimed as evidence of superior productivity of small-firm R and D.

However, Schmookler, the leading expert on United States patent statistics, has presented convincing evidence for the view that, contrary to general belief, large firms in the United States have a lower propensity to patent than small ones. He bases this on the empirically demonstrable effects of anti-trust actions on the patent policies of large firms, on the far greater possibilities of pre-testing before filing of applications in large firms, and on the greater security of large firms in relation to patent-sharing and know-how exchange arrangements. In his view, small firms usually cannot afford *not* to patent and cannot afford to wait, so that patent statistics tend to exaggerate the contribution of the smaller firms to inventive output, and that of private individuals.

The other major problem associated with patent statistics is the variability in importance of patents. One way of trying to get round this difficulty is by weighting patents, or by listing 'major' inventions. The difficulty of these methods is that they are very time-consuming, unless they are confined to a very small number of really outstanding inventions. In this case the difficulties which arise are those of subjective judgement in selecting the most important inventions, and of rating the relative importance of radical 'primary' inventions, compared with the vast multitude of secondary 'improvement' inventions. By far the best-known example of this technique is Jewkes' pioneering study which attempted to show that a majority of 60 major twentieth century inventions were made *outside* the R and D Departments of large firms.[17]

[14] C Freeman, *Measurement of output of R & D*, UNESCO, 1969.

[15] F M Scherer, op. cit., R. 11.

[16] J Schmookler, *Invention and economic growth*, [illegible]

[17] J Jewkes, et al., *The sources of invention* [illegible]

nited States Department of Commerce study[18] d an essentially similar view of the importance ate inventors and small firms, but with less cal supporting evidence.

kes' analysis may be criticized on the grounds me important corporate inventions were d, or perhaps more justifiably, on the grounds e contribution of large firms has become much nportant since 1930.[19] If his list of inventions is down, the share of corporate R and D is very efore 1930, but dominant since. However, after allowance for these criticisms, it must be con- hat Jewkes and his colleagues have made a case for the view that private inventors and firms have made a disproportionately large ution to the more radical type of twentieth- inventions.

ever, it does not necessarily follow that, be- naller firms may score better on numbers of or numbers of 'major' inventions in relation R and D inputs, they are *consistently more* in R and D performance, than large firms. all, it is important to note that a number of 'private' inventions were in fact developed ught to market by large corporations. The n of industrial R and D is a flow of *innovations*, fficiency in *development* is just as important as er stages of inventive work. Indeed, it is often icult to say who made an *invention* because of led chain of claim and counter-claim, but it possible to say more precisely which firms *innovation*, in the sense of first launching a new or process commercially. The relative per- e of large firms is better with respect to in- s than with respect to inventions, and Jewkes hat their role in *development* work (which is ar more expensive) is much more important. it is reasonable to postulate that small firms e some comparative advantage in the earlier inventive work and the less expensive, but ical innovations, while large firms have an e in the later stages and in improvement and o of early break-throughs. Moreover there are t differences between *industries* in the relative nce of small and large firms. In the *chemical* where both research and development work very expensive, large firms predominate in ntion and innovation. In the mechanical ng industry, inexpensive ingenuity can play part and small firms or private inventors rger contribution. Patent statistics reflect rences very clearly.[20]

ly obvious that there are some types of n which are beyond the resources of the small absolute number of components is one ch will affect this. The extreme case is for which more than 2 million components ired, but there are other more mundane ngineering products for which more than nponents may be needed, such as advanced jet aero-engines, electronic telephone exchanges, large computer systems, or some process plants. Large firms also have a comparative advantage where there are several possible alternative routes to success, with uncertainty attached to all of them, but benefits from the simultaneous pursuit of several.[21] Similarly, they enjoy an advantage where large numbers of different specialists are needed to solve a problem or expensive instrumentation is essential.

Probably the greatest advantage of the small firm lies in flexibility and internal communications. A number of studies of industrial innovation in Europe and the United States have high-lighted the importance of 'coupling' of marketing, production and R and D decision-making.[22] This may be much more easily achieved in the small-firm environment. In his study of the American scientific instrument industry, Shimshoni found that new small firms had played a critical part in innovating several key instruments and assumed their main advantages as motivation, lead-time in development work (from speed in decisions), and flexibility (Table III). He also concluded that *new* firms had a major advantage in external economies in the form of technological expertise brought from elsewhere in the R and D system. In his studies of 'spin-off' instrument firms, Roberts also pointed to

Table III

Comparative advantage of types of firms in science-based innovation

	Established large firm	*Recent firm small, on second or sub-sequent products*	*Entrepreneur first product*
Motivation to innovate	III	I–	I[b]
Ability to have or develop own knowledge, technology	I	III[d]	I[b]
Cost advantages, using outside knowledge	II	III[d]	I[b]
Resources available to penetrate market	I	II–	III
Resources for new product development	I	III[d]	I or II
Advantage in costs and speed of prototype and early model manufacture	*III*	*I–*	*I*
Flexibility to adopt new product or technology	III	II	I[c]+
Cost advantage, large series production and marketing	I	II–	III

I—Highest comparative advantages.
III—Lowest comparative advantages.
[a] May bring new product with him.
[b] Entrepreneur brings new product with him.
[c] Acts as agent on introduction.
[d] Mobility can overcome.
Source: D Shimshoni, *Mobility and innovation in the instrument industry* (Mimeographed), University of Tel Aviv, 1966.

ommerce, *Technological innovation, its environment and* Vashington, 1967.
lent of Science Policy, Paris, 1968.
ler, op. cit., n. 16.

21 R C Gutmow, 'Economies of Scale in R & D', *New Scientist*, 22 May 1969, pp. 422-3.
22 For example, T Burns and G M Stalker, *Management of innovation*, Tavistock, 1961.

the critical importance of technological entrepreneurs bringing with them ideas and half-developed new products from a scientific environment in university and government laboratories.

3 Conclusions and policy implications

Discussion of the relative importance of large and small firms in industrial innovation is sterile if it ignores inter-industry differences and variations in technology. A more fruitful discussion is likely if attention is concentrated on the *specific* advantages or diseconomies in particular types of innovation or industry.

It is evident that a national strategy or policy for innovation will need to make provision for the encouragement of *both* large and small firms' innovations, as both have an important role to play.

In relation to small firms there is perhaps the danger of forgetting that the vast majority of small firms will never make a radical innovation and that most of them do not perform any organized research. The radical innovating small firms exploiting a new invention are a very unusual and special type of small firm. But there is enough evidence of their distinctive contribution to warrant special measures to facilitate their success.

In relation to large firms there is the danger of forgetting that there may be important diseconomies of scale. But these may be to some extent overcome by ingenuity in management and social organization. It is possible that the more complex science-based type of development work with its relatively high costs may become more typical of manufacturing industry, so that the management of large projects such as pilot plants and multi-component systems will become an increasingly essential management skill in an advanced industrialized country.

3.4 Innovation and size of firm

C Freeman

This paper takes up three points from my first paper on the size of firm, and develops the argument on a more speculative basis. These points are, first, the relative significance of so-called radical or breakthrough inventions as compared with secondary, improvement, or follow-through inventions. It is very difficult sometimes to define or classify inventions in these terms, but I am assuming for the purpose of this discussion that there is some distinction between the [illegible] inventions than is usual.

The second point concerns the relative significance of innovation as compared with invention. To my way of thinking, in industrial and economic policy, we are concerned primarily with innovation.

And the third point is the relative significance of different industries within the overall framework of [illegible]

Finally, the paper discusses briefly some of the other important factors in explaining the innovative performance of firms in relation to size

The following paper is Mr Freeman's oral presentation, as given at the Conference (Ed)

Breakthrough and follow-through inventions

It is a little dangerous if, in discussions of invention and innovation, we think mainly in terms of the rather dramatic breakthrough, radical inventions, like television, colour photography, xerography, and so forth. By definition almost, the vast majority of firms in any country will never make radical breakthrough invention of this kind. So, if we were to base our policy mainly on this kind of invention, it would be very limited and one-sided. But we hope that the great majority of firms—anyway, a very large number—will be technically progressive; that is, they will be capable of improving their own production process, of launching new models and new or improved products, of using new materials in various ways, and of improving their technical efficiency. Leaving aside the question of how far it is necessary to perform organized research and development in order to achieve technical progressiveness, this is a desirable goal of economic policy.

To my way of thinking, therefore, the main emphasis of economic and industrial policies [illegible] on this overall technical progressive[illegible]

on the exceptional radical breakthrough invention. This does not mean that no policy is needed for radical breakthrough, but rather that it should not be the main emphasis of policy or its main guideline. The so-called follow-through or improvement inventions are often the most important from the point of view of the economic and growth effects. Let us consider one or two examples.

Undoubtedly, when Babbage invented his calculating machine in the 1830s, which might be regarded as the invention of the computer, this was a tremendous achievement. He never completed the working model, although he had a government grant for the purpose (one of the earliest cases of government support for research and development in this country), but it was a great original breakthrough in terms of inventive thought. It was also a breakthrough, in innovative terms, when Zuse, in Charlottenburg technical high school in 1939–40, first made a working computer which could do calculations, and it was used in the Henschel aircraft works in Germany during the war for work on aircraft design. Nevertheless, the improvement in calculating power and speed of these very early computers—and the same applies to the Harvard IBM machine—was not very much greater than the older types of calculating machine, or even than the abacus. There were some people who actually tried comparisons of the very early computers with really good abacus operators, and the difference was not all that great. The really big breakthrough came not with this very early generation of computers, but with the second and third generations, especially with transistorized computers, when there was a really enormous increase in terms of storage capacity and calculating power, and a huge improvement in terms of speed, efficiency and reliability; the whole state of the art of computing was transformed by these later models.

Coming to the economic effects, if we look at the early prophecies of what computers could do, we find that most people at that time, in the industry, in government and in the scientific world, thought that computers mainly would be confined to very special applications in the scientific sphere and in government. It was not really until the IBM 1401, the leading second-generation computer, that the idea caught on that computers would find very wide applications across the whole range of industry and services. I would argue that this achievement of bringing the computer to an economically useful tool for a wide range of purposes was just as important as the original efforts of Babbage or Zuse. It required a large number of secondary inventions and far greater resources. Any industrial policy must be just as much—or more—concerned with the second and third-generation models as with the original radical breakthroughs.

Consider another example. Take any of the new synthetic materials which have been introduced in this century. The original invention certainly was important, but very often we find that the original invention was actually made in the nineteenth century. The laboratory isolation, for example, of polystyrene was made in 1835; the isolation of vinyl chloride was made at Liebig's Laboratory, also in 1835; even the polymerization of vinyl chloride was made in 1912 at Griesheim by Klatte, twenty-five years before any commercial application. What was really significant in the innovation process of these synthetic materials was not so much the original invention or discovery, important though this was; what was really important, from the economic point of view, was the commercialization of these materials, the discovery of a viable process for making them on a large scale, the development of effective stabilizers and plasticizers, and then an immense amount of applications research to modify these materials to produce co-polymers, to produce new blends, so that they could be applied in a thousand and one different uses—in rainwear, in drainpipes, in building materials, as engineering materials, and so forth. This required an immense amount of applied research and development work in the chemical firms, a vast number of so-called follow-through or improvement inventions. The combined effect of all these follow-through, secondary improvement inventions was of tremendous significance for the economy in terms of the application of these synthetic materials and the growth of the chemical industry.

If these points are valid, rather a different complexion is put on the significance of secondary, improvement, and follow-through inventions for economic efficiency.

This distinction between the more radical invention and the improvement follow-through has implications not only in the discussion of the size of firms and the relative contribution of large and small firms, it also has implications in terms of the kind of motivation which applies in both types of invention. Psychologists and sociologists have a great deal to contribute to the understanding of this aspect of the innovative process. One of the points which emerges from various case-studies of innovation is the distinction between so-called 'science-push' and 'demand-pull' innovations. The radical innovations and inventions appear to be more 'science-push' and less 'demand-pull'. The improvement and follow-through innovations and inventions appear to be more 'demand-pull', originating from a close knowledge of the market requirements and the shortcomings of the performance of the first radical new products and processes. If this is correct, this means that policy for the radical 'science-push' type innovation is rather different from the other kind. The slightly eccentric, very enthusiastic, dedicated engineer or scientist plays a much bigger part in the radical 'science-push' type of invention or innovation.

This very much supports the conclusion of the Turner–Williamson paper relating to the complementary contribution of smaller and larger firms within a total system. Large firms may often wish to take up the more radical inventions from the smaller firms. But I should put a rather greater emphasis, arising from this conclusion, on policy for large firms and the significance of large-firm follow-through improvement inventions after they take over these inventions from the smaller firm.

The relative importance of invention and innovation

We owe this distinction between invention and in-

novation to Schumpeter, and it is extremely important. Innovation takes place only when a new product or a new process reaches the market. It would often be hard to say, in fact, who was the inventor of many products because often there is a long and tangled chain of invention and discovery. These chains are very important from the point of view of science policy; they are less important for economic policy.

To quote one or two instances: there was a patent taken out for radar in 1904 in Dusseldorf by Hülsmeyer. But the significant thing in this case was not the invention, which might be dated back to this patent, but the innovation: the first demonstration of [illegible] on innovation rather than on invention, then this shifts the balance in terms of policy a little bit more away from the small firm and towards the large firm. In Jewkes' book, which is the one most frequently cited—rightly so, in my opinion—as evidence of the importance of private inventors and small-firm inventors, we find that in his sixty-one case-studies quite a large number, although attributed to small firms and private inventors, were actually developed, commercialized and taken to the final point of successful innovation by larger firms. In his chapter on development, Jewkes concedes that there is a much stronger case here for the view that large firms are assuming an increasingly important role in the economy. Jewkes accepts fully that development is a far more expensive process than research or invention, and he accepts that, in a number of industries, the costs of development work are so high as to constitute an effective barrier to participation by small firms.

Is high cost innovation the exception?

This brings me to my third point, which raises the question: what are the exceptions? Jewkes concedes that in the case of chemicals, for example, in his own studies the majority of important inventions, as well as innovations, came from large corporate organizations. He rather treats the chemical industry as the [illegible] and often ingenuity on the part of outsiders without too much formal training in a particular discipline or firm, may be the main source of radical new ideas and inventions. He quotes a number of examples: the safety razor, the zip fastener, the ballpoint pen, colour photography and so on, where, apparently, ingenuity on the part of 'outsiders' did lead to major inventive success. I shall argue that the chemical 'exception' is, perhaps, becoming rather more the rule and that mechanical engineering ingenuity may be becoming rather more the exception.

It may be useful first of all to discuss the peculiarities of the chemical industry. Why is it that, by common consent, most of the important product and process innovations in the chemical industry over the last fifty or sixty years have come from large firms?

There is one obvious point, which is the degree of concentration in the industry. But I would argue that, [illegible] go a long way to explaining the relative success of larger firms. First is the question of pilot plant costs. At the NIESR and SPRU a study was recently completed of the principal new processes in use in the chemical industry. It was found that, of thirty major new processes introduced since the war, only three were introduced without a pilot-plant stage. To build and operate a pilot plant is rather expensive, typically costing rather more than £1 million, often a great deal more.

Of course, if small firms could find a way to dispense with the pilot stage (two cases were found where this occurred), then they might make a far more significant contribution in this area. But, at the present stage of chemical knowledge, it is not always possible to predict reactions on a large scale from knowledge of laboratory-scale reactions, and the behaviour of chemicals under changing conditions of temperature and pressure is not so accurately known that it would be reliable simply to scale up from laboratory to full-scale production.

This means that in most cases, with existing chemical technology and with the existing state of chemical scientific research, large firms have an advantage. It is true that chemical engineering is constantly improving and there are increasing possibilities of dispensing with pilot plants, but when this occurs a rather large team of chemical engineers is still required to make the extensive calculations which are needed.

Secondly, much chemical research, as Jewkes points out, is really a kind of molecular roulette. Jewkes described it as looking for a needle in a haystack when you know the needle is there. If you are looking for a needle in a haystack, you usually need fairly large resources to see it through, unless you can develop a new technique for the purpose. So that, where it is a question of sifting through tens of thousands of alternative possibilities, there is again an advantage in a large size of operations.

A third reason why large chemical firms may have a comparative advantage in many types of invention and innovation lies in the question of the contribution of fundamental chemical research to invention and innovation in this industry. It is perfectly true, of course, that it is possible to employ outside consultants: people like Staudinger and Ziegler were consultants to I G Farben and Hoechst; Michels played a very important part as consultant to ICI in developing polyethylene. But I would argue that it is hard for a chemical firm even to understand what people like Staudinger and Ziegler are talking about in relation to macro-molecular structure, unless they have themselves an ongoing research operation. An exception to this rule is the spin-off firm, where a scientist or an engineer leaves a very advanced laboratory and takes with him a body of know-how or a half-developed product, and exploits it. This is not impossible in the chemical industry, but it is [illegible] industry like scientific ins[illegible]

because of the differences in capital intensity and marketing thresholds, as well as the costs of experimental development.

It might be argued that the drug industry is an exception to these generalizations about the chemical industry and that, in the case of drugs, there is not the same problem of large plant construction costs or pilot-plant costs. As against that, in the drug industry there is the additional problem of the cost of screening and testing any new compound or drug. Because of justifiable legislation, this is becoming an increasingly expensive cost in drug innovation. Marketing barriers to the promotion of new drugs are also very high. Even in the industry in Switzerland, which is a classic case of a small country being highly successful in invention and innovation in one specialized industry, the drug firms which are responsible for this achievement are, in fact, large by international standards. The total expenditure on research and development of these Swiss drug firms is very nearly equivalent to that of the entire German or British drug industry.

I would argue, then, that there are considerable advantages for large scale R and D programmes in the chemical industry and that small firms contribute relatively a good deal less in this industry. But there are a number of other industries—including the food industry, fortunately or unfortunately—which are increasingly coming to resemble the chemical industry in their technology and processes. The innovations in the food industry are increasing the type of innovations which emerge from the chemical industry. British Petroleum, for example, is the firm which is launching synthetic proteins. It is the chemical engineering firms which launch new processes for manufacturing chocolate and milk products. The same kind of thing is happening in other processing industries, in metals and in building materials. The float glass process, which, by general consent, is probably the most important innovation in this industry since the war, resembles very much a chemical process innovation in its scale, the enormous costs of trial operations, and so forth. I would argue therefore that the chemical industry may become typical of the process industries, which embraces a much wider range than the chemical industry itself. This is not to deny that small firms will continue to make a significant contribution in these industries, especially to product innovations.

It might be conceded that the process industries have a large number of problems in common and that there are some very expensive types of experimental development work and research work in these industries, but it might still be argued that the engineering industry is something completely different and is still the field of the ingenious mechanic, where the private inventor and the small firm can make most of the important inventions and innovations.

I would accept this to some extent, especially for products like scientific instruments, where prototype costs are very small, tooling costs are small, and where the spin-off type of firm is extremely important. A scientist or an engineer can leave a laboratory where he may himself have half developed or used new instruments, and he can commercialize that know-how. This works as a once-only operation, but a very important one. The evidence of Roberts on Route 128, and of Shimshoni in his study of scientific instrument innovations in America since the war, is pretty conclusive that the main innovations in scientific instruments have been made by rather small independent firms, often new firms spinning off from larger laboratories, university or government laboratories. But I would also argue that there are a good many other engineering products in which this does not apply.

Consider, for example, the costs of designing and developing the range of heavy engineering products. The size of generating sets has increased from about 30–60 megawatts in the time of the Second World War through 90–120 megawatts, 240 megawatts, 500 megawatts now being installed, 800 megawatts, and even larger sets are now being designed. The cost of developing, designing and testing generating sets and the associated switchgear and transformers for that size of plant, is enormous. Even in the United States there are only two firms in this business: General Electric and Westinghouse. This has been the case for some time. It must be conceded that there are certain areas of very heavy design and development costs where it is just not realistic to talk about small firms coming into the game. This applies a fortiori to nuclear reactors. It applies also, in my view, to an increasing range of other mechanical equipment, for example, heavy pressure vessels, heavy pumps, heavy compressors, certain types of diesel engine. In all these fields economies of scale have led to vast increases in unit size and design complexity. In the machine tool field the application of numerical control has led to the more advanced concept of a machining centre performing a great variety of possible processes within one combined operation. But the costs of developing these machining centres are extremely high, much higher than the costs of developing an individual machine tool, and the combination of specialist skills required is much greater.

Thus, even within the engineering industry, there are quite a number of areas where rather heavy commitment of resources is required to do successful innovative work. The factors contributing to this situation can be summed up as the costs of pilot plant or prototype development and testing, the range of new materials coming into use, which is very much wider than it has ever been, the sheer number and variety of components in some systems, the complexity of the instrumentation and test gear required in a wide variety of industries, the requirement for an input of basic research to couple up with external basic research, and the range of specialist disciplines required. What might have been the exception in the nineteenth or early part of the twentieth century, or even up to the Second World War, is probably becoming rather more typical of innovative work in industry. But I would readily accept that there is a need for far more systematic empirical investigation to establish the main trends in each branch of industry. I would also accept that future breakthrough inventions may transform the situation in some of these high-cost areas, and that it is essential to nourish the sources of such breakthroughs.

If the argument so far is valid, the policy conclusion to be drawn is that industrial policy needs to pay more

attention to the improvement and secondary inventions, to the innovations more than the inventions, and to the rather high cost of many innovations.

Some implications for the development of policy about the size of firm and market organization

This has important implications when we are considering policy in Britain relating to the size of firm in certain industries. Very large firms may be inevitable for innovations in some product groups. This question of the humped distribution of research [illegible]

It does not necessarily mean that the giant firms are contributing less in the way of innovations. Consider the case of the computer industry. IBM probably has a lower research intensity than the British leading computer firm, ICL. But this is not because ICL is making more inventions and innovations; it is simply because IBM is very good at selling computers. This automatically means that they have a lower research intensity. It is necessary to remember, in considering a ratio, that it *is* a ratio, either of net output, or sales, or employment. It could be maintained that the giant [illegible]

policy, to concentrate too much on the question of size of firm: this is only one aspect of the problem. Although we need far more information, we have had quite a significant increase in the data available over the last five or ten years. There have been, in Europe and in the United States, at least a dozen quite important empirical studies of industrial innovation—at the NPA, MIT, North Western, Illinois Institute, NIESR, Manchester and other universities. All this has been on top of the earlier important work by Jewkes and by Carter and Williams in the 1950s.

It cannot be said that we have nothing to go on. We do have a whole number of hypotheses in relation to innovation and some of them have, at least partially, been tested. It is not unreasonable to say that there are three or four main points of consensus which emerge from almost all of these studies.

First, there is very general agreement that successful innovating firms, whether large or small, tend to be those which bring about a very close coupling between the prospective customer and the research and development work. This may be done in a variety of different ways. It may be done by associating the customer directly with the development work. It may be done by very good market research, imaginatively conceived. It may be done by somebody from the prospective customers or the prospective market themselves developing new equipment. However it may happen, a common characteristic is this very close coupling of market knowledge with research knowledge.

A second characteristic of successful innovating organizations, again whether large or small, is flexibility in allocating resources during the development work. It seems that this flexibility, this capacity rapidly to increase funds or to change direction, is rather more important than any formal system of budgetary control or project evaluation. This leads, in turn, to another very important characteristic, which is speed in innovative work and in telescoping different stages of the innovative process.

A third factor which emerges from a great many of these studies is the importance of communication with the outside science system, the links which enable the firm to draw upon scientific inputs which can very much increase the efficiency of its innovative work and facilitate novel solutions.

The fourth factor which emerges from most of these studies is the very great importance of an efficient internal flow of information, with very few communication barriers within the innovative firm, again whether large or small.

These points indicate the kind of advantage that small firms may have in many types of less expensive innovation. Shimshoni's schematic representation from his study of instrument firms (Table III in my previous paper) suggests rather more explicitly the comparative advantage of small firms. However, if one identifies the small firm's advantage as lying not necessarily in smallness itself but in these factors, it becomes a possible alternative to simulate these advantages in a different environment. It may be that firms like I G Farben, for example, which were very successful as chemical innovators in the period from 1925 to 1945, were able to simulate some of these advantages, and some large American corporations have deliberately set out to do this.

The difficulty in generalizing in this way about innovation is that most of the studies which gave rise to these conclusions are rather limited in scope. None of them are based on statistical sampling. They are often based on a few case-studies, perhaps a dozen, or on a small number of interviews. They usually depend on the account given by innovators or entrepreneurs themselves of their own innovation, after the event, and are therefore subjective and one-sided. Often there is a mythologizing process that goes on in these matters. We are trying at Sussex, in a project on industrial innovation (SAPPHO), to give a more secure base for generalizations of this kind. We have tried to do this by introducing experimentally a 'control group' of failures. It is not really enough to say that successful innovators have this, that and the other characteristic—size, good communications, market research and so on, because all these characteristics might equally apply to firms which have failed with innovations. What we have tried to do is to take pairs of firms, both of which attempted to make the same, or very similar, product or process innovations, and then to measure these characteristics both in the successful and in the unsuccessful firm, thereby trying to discriminate between those variables or that combination of variables which is most important in explaining success or failure.

We are trying to measure a rather large number of variables, because, from scanning the literature, [illegible] came to the conclusion that there [illegible]

3·5 Big business mergers and anti-trust laws: a businessman's point of view

H Suzuki

Foreword

Much public attention and discussion has lately focused on a whole spectrum of merger problems, from monopolies and oligopolies to price fixing and restraint of competition, and this attention has been not just in the context of the legal implications but from the perspective of industrial policy and business management as well.

One of the most crucial aspects of an anti-monopoly policy and its enforcement lies in finding a proper way to harmonize legal interpretations with economic rationale. For inherent in an anti-monopoly are important considerations of corporate, industrial and national relations—namely, corporate self-responsibility and autonomy v. corporate public responsibility; corporate expansion v. market dominance; and scale v. efficiency. As a result, a diversity of opinions have ensued, some poles apart and some overlapping.

Furthermore, it seems that a prerequisite to a proper [illegible] national and international position in which the industry in question finds itself, as well as of the specific and changing business environs Theoretical arguments of the problem in only general and abstract terms, therefore, may even be dangerous.

This writer, as a businessman who feels certain of [illegible] personal opinion on mergers in general, and the Yawata-Fuji Steel merger in particular, as a model case which has during the past year stirred considerable public debate in Japanese economic and academic circles.

1 Development of the Yawata-Fuji merger case to date

The Yawata Iron & Steel Co , Ltd (hereafter called Yawata) and the Fuji Iron & Steel Co , Ltd (hereafter called Fuji) are the offshoots of the Japan Iron & Steel Co., Ltd which was owned and operated by the government. Following its dissolution by the United States Occupation Forces in 1950, the present Yawata and Fuji Steel Companies were re-created as two separate and private companies

The post-war Japanese Government designated steel, along with coal, utilities, and fertilizers, as essential industries to be given top priority in the post-war reconstruction, and they enforced every necessary policy measure towards achieving that end As the nation's recovery subsequently got well under way and the economy was firmly restructured as a free economy, the steel industry took the initiative in launching upon massive capital investments, mainly constructing large integrated steel works in coastal areas. The result is that Japan presently is the second largest steel producing country in the non-communist world.

At present, the six major integrated steel producers in Japan are Yawata, *Fuji*, *Nippon Kokan*, Kawasaki Steel, Sumitomo Metal and Kobe Steel, all of which, except for Yawata and Fuji, were started as private companies. Their respective market shares as of the end of fiscal 1968 are:

Market share by companies

(Fiscal 1968)

	Pig iron (%)	*Crude steel* (%)
Yawata	22·5	18 5
Fuji	22 2	16 9
Nippon Kokan	16·2	12·6
Kawasaki Steel	12·9	11·4
Sumitomo Metal	13 3	12·0
Kobe steel	7·1	5 4

The combined shares for Yawata and Fuji, the first and second largest respectively, are 44·7 per cent for pig iron and 35 4 per cent for crude steel.

The sales earnings of Yawata and Fuji, if merged, would total $2·5 billion on the 1967 figure basis—an amount which ranks closely behind US Steel, and Bethlehem Steel and roughly equal to ICI and National Coal Board earnings.

With 1965 as the base of 100, the following production indices demonstrate the path of growth that the Japanese steel industry has followed.

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results would offset the evils of oligopoly. The same firms testified to the lack of co-operation within the keenly competitive iron and steel industry. In this connection, the firms stated that they would start marketing the products in question in a positive manner.

Furthermore, a statement was made to the effect that the proposed merger does not aim at restraint of competition, and the argument developed in one sector on whether or not a big enterprise is essentially good-natured or ill-natured.

These arguments are based on the assumed results of the merger.

It is a fact that there will be influential and aggressive competition in the country after the merger. Under the circumstances, discussion for and against these possibly harmful, possibly harmless effects will inevitably be an abstract argument, and I believe that the merger should be judged on other criteria.

(iii) *Justification of the big business merger*

Because this merger would combine the largest and second-largest steel makers, opponents fear that similar mergers of big firms will take place one after another if it is permitted. Against this line of argument, proponents of the merger argue that being 'big' is not in itself evil, and emphasize that the merger's combining the largest and second-largest firms alone is not reason for opposition.

Side by side with this controversy, there is debate on whether or not management efficiency increases and good results follow when a firm becomes large through a merger. Those who are directly involved in the proposed merger emphasize its advantages and many theories are presented in support. On the other hand, academic circles claim that there are few instances of big firms' producing epoch-making innovations.

I do not believe that the scale of an enterprise alone should be relied upon as the criterion for approving or rejecting a merger. I also believe that whether or not a company should become large is a question for the management rather than a criterion to be used approving or rejecting a merger.

5 Personal observations

(i) *The principle of self-responsibility and the free enterprise system*

As a preliminary step for discussion of the merger issue we must have a common viewpoint with respect to our existing social system.

In principle, I support the free enterprise system and hope to see society advance through free will and creative minds. I subscribe to the free enterprise system and the free industrial society which is built upon the principle of self-responsibility for industry, that is to say that the ultimate entity of development for the national economy is the enterprise, and that along with this duty the enterprise is held responsible for the results of its activities.

I believe, therefore, that if the top management of these enterprises has come to the conclusion on their own responsibility that the merger is indispensable, then it should be approved so long as it does not create problems for the national economy as a whole. It is unjust to regard the motivation of enterprises as evil. Big businesses nowadays have to give due consideration to the social welfare.

Therefore, for a third party to meddle into the abstract discussions for or against a merger and give his approval or disapproval based on the discussion, denies the principle of enterprisal self-responsibility and should be regarded as an act of unjustifiable intervention.

The merits and demerits of a merger should be left to the judgement of the parties concerned, and the management should be held responsible to society for the result of their judgement.

It would not be fair to restrict the freedom of an enterprise's decision-making merely on account of indefinite speculation that the merger may possibly involve illegal practices.

Merging is different from forming cartels, and is in itself a neutral process. The intent to dominate the market as such cannot be directly associated with the intent to merge. It also goes without saying that those enterprises which have gained large shares of the market by selling quality products at low prices are in general not in violation of the anti-monopoly law.

From this angle, it naturally follows that, while merger aiming at control of the market should be disapproved, those not aiming at market domination should not be prohibited if there is no other social reason for censure, even though the merger may slightly increase its share of the market.

Does not the theory of 'ill-natured business' which holds that an enterprise which has control of the market will be necessarily acting against the social interest share a common base with the denial of the free enterprise system. It is the spirit of freedom of business that a merger must be approved unless it works against the welfare of the public in specific terms, and this principle is related to the free enterprise system.

In order to relieve any doubts about the future, the authorities should resort to administrative measures if a merger creates ill-effects, and this action would be quite possible under the current stipulations of the Anti-monopoly Law. If necessary, the organization of a body for checking such ill-effects may be considered.

At the same time, enterprises should keenly recognize their social responsibilities collateral to the principle of self-responsibility and the free enterprise system. They should refrain from any practices which may create misunderstanding as to their motives, and should prove by deed that enterprises exist for the good of the society.

Based on my fundamental awareness of the current social system, I cast my vote in favour of the proposed Yawata-Fuji merger.

(ii) *The problem of scale*

I believe that the size of an enterprise is a matter of economy and management, and that it is nonsensical to debate the undesirability of big size from a purely ethical viewpoint. In a sense, the growth of an enter-

[illegible]
avoided, but bigness per se should not be taken up as a social issue.

Big business organizations are burdened with the problem of how they can be effectively and efficiently managed and operated. Those who fail to answer this question will go out of business.

Those dinosaurs which once dominated the earth were, after all, unable to meet the competition for survival and disappeared because of their size. There is no guarantee in this rapidly changing age that the leader of today will be the leader of tomorrow. Even the biggest must die if it deteriorates into an inefficient organization. In this sense, the iron and steel industry will continue to be highly competitive even after the merger.

The guiding principle for the advancement of society lies not in size—whether big or small—but rather in the concept of efficiency. I, as a business man, do not feel that a competitor poses a threat simply because his firm is big.

The real issue is how to structure the society in such a way that inefficient organizations cannot sustain themselves in it. The society should not reject bigness per se.

(iii) *Mergers and competition*

I have stated my view on the principles of self-responsibility for enterprises, the free enterprise system, and the scale of enterprises in general. In short the key principle by which to advance society is to establish and maintain a fair system of competition.

The principle of self-responsibility assumes the existence of the fair competition system. Because of the system of competition, inefficient industries are not permitted to exist.

As such, the fair competition system is an extremely important institution for our society. In reality, however, the conditions governing competition must be viewed open-mindedly.

In the first place, the stage of competition has shifted from the domestic into the international scene. The world trend is developing in favour of eliminating economic boundaries, particularly those between the advanced nations, and I am in favour of this. In this connection, it becomes necessary to assess any development always from the angle of international competition.

In the future, there will be many cases where intense competition will develop in industries where the number of domestic enterprises is few, but they must fight against foreign enterprises as well. It is also important for domestic enterprise to accumulate sufficient power to be able to go overseas and compete with foreign enterprises.

Whether or not the merger of Yawata and Fuji will create restraints of competition must be studied in light of the internationalization of competition. Thus, I believe that when the two firms mentioned, as one objective of their merger, strengthening their international competitive position, their approach was justifiable.

In the second place, we must consider the unique characteristics of the nation and its people. For instance, Japan's economy has achieved high growth during the past ten years. One of the major factors contributing to this, I believe, is the steady and enormous investment in new technologies and equipment, investment motivated mainly by that desire for expansion which has focused the efforts of Japanese industry on economic growth. Industries tend to place greater emphasis on growth and expansion than on profits.

This has led to intense competition among firms for quantitative expansion irrespective of profitability. Even in the chemical industry to which I belong, the price level of petrochemical products made in Japan is perhaps the lowest in the world.

Furthermore the financial conditions of Japanese enterprises are below international standards, generally the worst among the advanced nations. This expansion-minded and competition-orientated character is characteristic of the Japanese.

We call this condition 'excessive competition'. How to convert this state of affairs into fair competition is our greatest concern.

The iron and steel industry is one of the most intensely competitive industries in Japan. The merger of the largest and second-largest producers will not alter this.

In view of the sustaining economic growth and the [illegible] business practices, any restraint of competition which would adversely affect consumer interests.

This is Japan's current situation, but these conditions may not apply to other countries even to the same country in other times. In evaluating the merger, it is necessary to be fully aware of the reality before making a final decision.

It is also necessary, in studying the competitive conditions to take a flexible approach by avoiding a fixed attitude toward the existing concepts of industrial categories—for instance comparing the growth rates of such different materials as aluminium or plastic and applying the comparison to this instance.

In summary, and from the standpoint of competitive conditions as well, I am in favour of approving [illegible] national economy, as well as to the advancement of the social welfare of the people. The problem arises when legal experts assume the Anti-monopoly Law to be the ultimate justice and strictly enforce it instead of making any overall assessment of the prevailing situation.

After having reviewed the Yawata-Fuji merger issue, I am more aware than ever of this problem.

I look forward to the administration of the measures most appropriate to this period of rapid transition, and based on the recognition of the importance of the

Anti-monopoly Law as a part of higher economic policies.

Unfortunately Mr Suzuki was unable to attend the Conference, and Mr T. Ikeuchi introduced the above paper in his place. After a brief summary of the paper, Mr Ikeuchi continued as follows (Ed.):

If I may, I would like to give you my own views on this matter. First of all, The Fair Trade Commission did not examine this case from the viewpoint of whether this merger violates the prohibition of economic oligopoly in general, but rather the Commission emphasized that the merger may substantially restrain competition in four particular fields: tinplate for food cans, foundry pig iron, rail for railways and steel sheet piling.

Some critics oppose this merger because the newly merged company would be unduly large in scale and productive capacity as compared with other iron and steel companies in Japan.

However, the object in disallowing the merger is, in my opinion, mainly in order not to restrain fair competition. Therefore, the decision must be made after concrete and specific fact-finding rather than on the basis of abstract argument. If this is so, the attitude of the Commission seems to be quite realistic. But, as the aforementioned four items comprise only less than 10 per cent of the whole output of both Yawata and Fuji, and as I understand it counter measures have been prepared by them, oligopoly, if any, in these items should invalidate the merger as a whole.

Secondly, we must make a distinction between the consumer goods industry and producer goods industry, such as iron and steel, according to their economic role in society. The producer goods industry is as indispensable to all other industries as food is to man.

The most essential point for the producer goods industry is to meet the needs of the whole industrial world in both quantity and quality at a stable price. If competition in the producer goods industry results in a big fluctuation in supply or market prices and causes economic instability, from viewpoint of the national economy, such a keen competition in these industries, at least, must be restrained.

Some people insist that 'the bigger the better in competition', but apart from competition in creative power such as innovation of new techniques or development of new products, there must be some restraint in competition itself. Liberty is the basic idea of a democratic society, but every component of the society must observe discipline. In the same way, fair competition is an essential element in a free economy, but we need some kind of social restraint in competition itself. I like to call this competition in good order.

As Mr Suzuki pointed out in his report, in Japan, excessive competition itself poses a problem. And it should not be overlooked that as a result of excessive competition, the profit ratio shows an extremely low level.

For example, the after-tax profit rate against total assets in the 1960's was 6·7 per cent in the US and 5·2 per cent in the UK, but in Japan, it was 2·5 per cent, about half that of those countries.

Another example has been in the field of plant and equipment, where excessive investment over the real demand caused a fall in the operation rate preventing a projected production cost reduction.

This overcompetition is the issue in Japan. And the Yawata-Fuji steel merger should be regarded as one step for the Japanese steel industry to extricate itself from the present excessive competitive state and move toward a more orderly one on an international level, rather than being regarded as a move to form an oligopoly.

In conclusion, I am convinced that, in considering the actual operation of the Anti-monopoly Law, full attention must be paid to the balance of economic interest between entrepreneurs, employees and consumers in general.

This law clearly states in Section 1, that 'it aims to promote free and fair competition, to stimulate the initiative of entrepreneurs, to encourage business activities of enterprises, to heighten the level of employment and peoples' real income, and thereby to promote the democratic and wholesome development of the national economy as well as to assure the interest of consumers in general'.

Particularly I would like to emphasize the phrase 'to stimulate the initiative of entrepreneurs'. Probably every person agrees that prosperity of the national economy largely depends on how much each enterprise can develop its initiative power. Such being the case, even the Anti-Trust Law has to promote the initiative power of the management I sincerely hope that the Fair Trade Commission will make a decision based on this understanding.

3.6 Market structure in relation to firm growth and innovation

G Albrechtskirchinger

I Introduction

Economic policy must define a number of goals in [illegible] d [illegible] question—which market structure for the days to come will be the most conducive for innovation. The issue of firm size, market structure and innovation has been dealt with in literature initially on a theoretical basis. There is little evidence based on empirical studies, and this very fact will prevent us from giving a generally valid answer to the question formulated above. Still, the discovery of some guiding elements and principles of innovation will be helpful. It is of considerable importance to understand the conditions and the process of innovation in a world where government control and intervention in firm growth and industry structure is apparently coming to be considered as one of the elements of economic policy.

II Invention—innovation

At the outset of the term innovation calls for some definition. It has become accepted to differentiate between invention and innovation. Invention is to be described in economic terms somewhat along the lines that we use for the traditional concept of patentability: i.e. the description of a new and usable product or process which represents an advance in the technical art.

Innovation is the realization of an invention which satisfies the inherent needs set by technology and by the economy; in other words a marketable industrial production. We may therefore call innovation the descriptive *and* tangible result of a creative effort in the technical field.

It is often a very long way from invention to innovation. The fact that the time-span elapsing between invention and innovation has rapidly and increasingly diminished in the last decades does by no means imply that the necessity of investing creative energy and considerable financial means to overcome the technological threshold has diminished. Nor can this process take place without the test of the market since it is only the production of the goods in question in sufficient number, at competitive prices, and in superior quality that justifies the term innovation.

It is evident that invention and innovation cannot always be distinctly separated. The process of innovation is by no means void of creativity. There may be innovation without directly preceding invention, but innovation will always be coupled with inventive activity.

III Basic conditions for innovation

It would be a mistake to assume that market-structure and company size will be sufficient to analyse the phenomenon of innovation. Technical creativity will also depend on a host of other factors, some of which are quite intangible.

At the root of all is the inborn and typically human quality to be creative and to improve surrounding conditions. There are clearly a good many intangible and imponderable factors which are responsible for either stimulating or stifling human creativity. To illustrate, it may be said that social policy, overall and on the company level, will be an important prerequisite for creativity. It is obvious that the employed company researcher will want to be consulted on fundamental problems of research policy; he is likely to work harder and to perform better when an organized system of mutual orientation and consultation is the rule of research teamwork and thereby [illegible] he enjoys the right to have a share of the company's profit derived from his invention or innovation instead of having signed a waiver abandoning without or with only inadequate remuneration 'his' invention to the company.

The creativity of the individual employed in industrial research thus depends largely on [illegible] tional and emotional aspects of social structure, [illegible] which cannot be but neglected by purely [illegible] statistical enquiry. Other factors which are [illegible] importance and not per se dependent on [illegible] ture and firm size are those of the [illegible] equipment put at the disposal [illegible] the technological production [illegible] decide on the success or failure [illegible]

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> industry, the fitted curve has an inflection point and among the largest few firms innovational effort generally does not increase and may decline with size.

and he states in the same paper:

> The quantitative work of the past decade, while acknowledging Schumpeter as its inspiration and intellectual parent, has in fact been testing a different hypothesis and one having different policy implications. The restated hypothesis, since it has envisaged tests cast in terms of regression analyses, must also be stated in these terms. *If one can sum up Schumpeter in the statement*, give me factual evidence of innovational activity in the market economy and I can safely predict the presence of large firms having temporary monopoly power, the restated hypothesis is, give me x innovational activity and I will give you $b_1, b_2, \ldots, b_n$ values showing how much of x can be 'explained' in terms of firm size, the level of concentration, and similar a priori relevant variables. The policy implications of the original and restated versions are also different. Schumpeter simply argued that any indiscriminate assault on bigness and market power, taken out of their evolutionary context, would deprive the capitalistic process of its source of progress. The newer version proposes to tell us in quantitative terms, to the extent available data permit, how much, where, and up to what point innovative effort (and results) are attributable to such factors as firm size and market structure.

In as much as this literature can be summarized at all this is to be considered an excellent summary.

There is other American material which has received maybe even wider publicity than the above mentioned economic literature. It is the material relating to hearings on economic-concentration held before the Sub-Committee on Anti-Trust and Monopoly of the Committee of the Judiciary of the US Senate. Part of this evidence is devoted exclusively to the subject we deal with today.[3]

This again represents rather voluminous material, less of scientific and more of documentary nature, but nevertheless of importance for our discussion. Hearings before a United States Senate Committee must, however, be seen in their political context. The Sub-Committee wanted to investigate into the effects of economic concentration on small and medium-sized business. Aspects of technology and innovation were therefore discussed with a view to possibly improve the situation of small and medium-sized industry. This intention is reflected in the choice of topics and the selection of witnesses. There was no need to elaborate on the role of the big companies in innovation and to present a complete analysis. It is of interest to note and cannot be omitted that the minority on the Sub-Committee at several occasions raised objections because they felt that the majority did not carefully enough direct the hearings within these inherent limitations.

In the course of the hearings many of the economists testified who in recent times had done research on the interrelationship between firm size and innovation. Their testimony was based on the published results of their studies and did not procure any radically new elements. They agreed that minimal or optimal firm size in regard to innovation, if it can be established at all, would vary greatly from industry to industry. As to the research input it was pointed out that according to statistics published by the National Science Foundation the companies with more than 5,000 employees account for more than 80 per cent of the total research and development expenditure. Much room has been given to testimony relating to the remarkable achievements of individual inventors who are not company employed and to the contribution of small companies to technological process. In this respect, however, the necessary careful distinction between invention and innovation was not always clearly made. Also this part of the evidence is too much the result of a random selection to allow generally valid conclusions. Many of the examples given refer to historic periods which had quite different conditions from those to be found today in research and production.

It is in short not the type of material which is conclusive enough to provide a basis for policy decisions.

V The situation in Europe

Europe must devote great care to the further development of its industrial efficiency. No doubt, the specific American evidence on firms size and innovation will make us more aware of the complexity of the problem and will help us in investigating our own situation especially as to the methods used in such investigations.

There is no doubt that the American evidence, if it would allow certain generalizations, could not be transposed to the European situation. The problem of non-applicability of socio-economic evidence based on conditions in one area to other areas would be worth a separate study especially as far as the United States and Europe are concerned. Because of the common heritage and the truly international technology which guides the advance of our respective industries, we are likely to assume that the basic developments of industry and commerce as well, once introduced in the pioneer land, will automatically be repeated in Europe. In reality there are differences in the underlying structures and in the tradition which must be taken into account whenever experiences in the one area are used for tackling identical problems in the other area. Thus it is not contested that the American

nent. Especially in the field of innovation we must carefully take into account existing differences.

There is for example a considerably higher proportion of government financing of R and D in the *United States, and it is quite evident that this factor* also influences the intensity and the direction of research. Furthermore, the process of invention and of technological creativity depends on a great many factors completely apart from firm size and market structure, which cannot be expressed in comparative figures. But, even when for one particular aspect the investigation is based on undisputed statistic material, the same method applied in another area may not yield results which could be honestly compared. To illustrate this let us consider the method of evaluating patent statics, be it applications, granted patents or effective use of patents, in order to assess in a data-controlled manner the inventive trend. The method as such is doubtful, since patents document only partly innovation and technological creativity and the

[3] Vol. III, *Concentration, Invention and Innovation*, Washington, 1965, Vol. VI, *New Technologies and Concentration*, Washington, 1967.

statistical data, no matter how complete, cannot be interpreted safely as to the value of the invention. But this method will fail completely in procuring comparable data when two different countries are involved. The reasons for this immanent failure are manifold; even in two countries that both have the examination system, patents will be examined and granted on differing specifications and grounds. The very basic decision, for example, whether a patent is to be filed or not will appear in a completely different light in Germany where the legislator in providing a right of remuneration for the employed inventor forces company management to arrive quickly at the decision whether to make use of or to abandon the invention made by the company employed inventor.

Another reason for the non-applicability is the fact that the absolute size of those US companies that are called the giant corporations or the very few big firms do not have their counterpart in Europe. There is abundant statistical material on this, as for example in the well-known lists published periodically by *Fortune*. Also if one compares industry structure it will be noticed that the striking phenomenon of the extremely diversified company, which is nowadays called the conglomerate, does not yet exist in Europe and it is not certain at all whether it will ever come into use here.

To sum up: American evidence on firm size and innovation considered as such does not lead to generally valid results. Even if the contrary were the case, any conclusions drawn could hardly be applied to situations outside the United States.

European studies on market structure, firm size and innovation are at a very rudimentary level. It is to be hoped that at some future time we shall have reliable material at hand, in spite of the great methodological problems that exist.

What we have in Europe are some data comparing company size and productivity of large companies between the United States and Europe. We also have material on the phenomenon which is called the technological gap.[6] The material presented by the Commission of the European Communities in its second programme for middle-term economic policy includes comparative data on the turn-over of the largest firms and their productivity in a number of important industries. Especially the latter figures clearly indicate the overwhelming superiority of American industries. The two tables with comparative data based on the 1967 situation and first published in *Fortune* are quite self-explanatory and in their conclusions so well-known that we need not mention details.[7]

In its analysis the Commission concludes that the structure of the Common Market industry must be adapted to the needs of global competition by a number of measures. In this light it appears that rapid company growth, both internal and by merger, will have to be considered as a perfectly normal and sound procedure in order to raise industrial productivity to the level needed for survival in international competition. The measures proposed by the Commission contain of course also other elements and take into account that certain goals of economic policy, as for instance a balanced market structure and the maintenance of competition, must be fulfilled. Thus the proposed policy trend of firm growth is only part of the cure.

The OECD material published in 1968 on the technological gap clearly indicates the United States superiority in originating and diffusing innovation. There seems to be no single or simple cause for this marked difference. The report lists a great many, and among them inadequate firm size. Here again the element of firm size is only one factor and should not be generalized. In this connection, however, it must be pointed out that in certain industries—and primarily in the chemical industry—there is little or no reason at all to deplore a technological gap. This is indicated in the OECD report and this is quite clearly the opinion of the chemical industry in Germany. The material referred to may lead to different policy proposals. But it shows very clearly that the main disparity is the generally lower productivity of European industry in comparing the performance of the largest firms in the main branches of industry. When we recall the fact that the largest companies of each branch in Europe and in the United States show a great difference in size respectively, there seems to be much indication that the principle of economies of scale is demonstrated by the American companies. Partly the increase of productivity we need will have to be met by more and better innovation. In comparing firm size and market structure in the United States and Europe there seems no indication at all that industrial policy in Europe could afford to be restrictive in regard to firm growth. On the contrary it is likely that further rapid growth, internal and external, will be necessary in order to keep up the needed rate of innovation.

VI Conclusion

Considering the global competitive situation, European industry is faced with the problem to find its own pattern of optimal conditions for innovation. Specific studies yet to be undertaken may eventually give us data to formulate policy elements of firm size and market structure for such a pattern. It will be safe to assume that there will be no uniform pattern to be applied to all industries, because existing differences will call for different measures in order to stimulate innovation. Considering the American superiority generally prevailing in productivity and innovation, and taking into account the considerable difference in size between the largest US firms and the largest European firms in the most important branches of industry, there seems to be no justification to implement government control or intervention on the future growth of European companies. Industrial experience shows that innovation is performed by both big firms and small firms, and quite often in a natural

6 *Zweites Programm für die mittelfristige Wirtschaftspolitik. Amtsblatt der Europ.* Gemeinschaften L 129, 30. Mai 1969; *Gaps in Technology*, General Report, Organization for Economic Co-operation and Development, Paris 1968; *The Size of European Companies, Addendum to the Report on the 1968 Financial Year*, Compagnie Lambert pour l'Industrie et la Finance; *Unternehmensgröße und internationale Wettbewerbsfähigkeit*, Prognos AG, Basel, 1968.

7 Cf. Appendix, pp. 13, 14.

division of labour. Government policy can only provide for generally favourable conditions. It cannot really judge and foresee which size of company will innovate best. It is likely that such government control would more retard than advance the process of innovation. Even most of the forecasts made as to the optimal size of a production unit, merely on the basis of technology, were valid only for a short period of time and soon had to be revised. The phenomenon of creativity and innovation, however, is much harder to grasp and to foresee, and once a wrong government decision were made it would lead to permanent loss. Government control on firm growth based on general principles of competition policy may therefore run the *risk of endangering innovation and the needed increases* in productivity.

Group 4
The international firm and international aspects of policies on monopolies, mergers and restrictive practices

4.1 Chairman's report

E Gunther

I have to report on the work of working party number IV. I think it would be fair to thank on behalf of all the members and of course a considerable group of about forty members, the Board of Trade, as well as the OECD as co-sponsor of this conference, for the opportunity to have an exchange of views between the academic profession, businessmen and administrators. I think also that the fruitful co-operation we had, in order to cope with the present problems of our modern world, was a unique opportunity. Also I think we have to be thankful for the hospitality and the friendly atmosphere we have found here in this famous university.

The discussion of our Group was devoted to the international firm and international aspects of monopolies, mergers and restrictive business practices. The discussion of the Group was based on the papers of four main speakers. First was Mr Wertheimer's paper on the international firm and international aspects of policies on mergers, second was Professor Kronstein's paper on the multinational corporation and restricted activities. Third was Mr Steuer's paper on competition and the multinational firm, the United Kingdom example, and fourth was Mr Copp's paper on some practical aspects of different attitudes to anti-trust. In addition Mr Fugate presented a paper on the international aspects of United States Anti-Trust Laws, a paper which was designed to explain why reference to cases decided the purpose of the United States law, their rationale and their hold on foreign commerce of the United States.

I think it would be wise to give a very brief survey of the main points of those papers, and I may mention the following. Since Mr Wertheimer wanted to deal with the inter-relationship between the international firm and the nation state he defined the international firm, as he called it, the multi-national firm or the transnational firm as it was also called, as an enterprise with central control operating in geographically diversified markets belonging to different legal spheres, and inter-dependence between the composite parts through some kind of capital sharing. After a survey of the historical evolution and remarks on the organization and location of the decision-making power, Mr Wertheimer described the possible attitudes of governments to its foreign direct investment. The paper then described reasons for international mergers and showed the attitudes of governments to such mergers. On the basis of case examples from the United Kingdom, the United States and the EEC, Mr Wertheimer analysed the attitude of governments concerning international mergers with respect to anti-trust and to other aspects. Extraterritorial application of anti-trust laws gives rise to political conflicts, and Mr Wertheimer proposed as the solution the adoption of a consultation procedure similar to the informal procedure developed in EFTA in relation to complaints under Article 15 of the EFTA Convention. In his address to the Working Group Mr Wertheimer quoting Professors Perlmutter and Galbraith, as well as Kahn and Wiener, said that in a period of fifty years from now the industrial system would be only a part of life of relatively minor importance and would therefore be of much less concern than today. He admitted however that today's problems had to be solved with 'vision, imagination and the courage to face even those developments'.

Professor Kronstein in his report gave examples of restrictions of international trade by international firms. He discussed the impact of vertical integrated enterprises, for example in the field of cobalt, aluminium, oil and electronics. He maintains that apart from collective restraints of trade a vertically integrated international enterprise could restrain international trade by allocation of markets, for [illegible] to practices of international firms, and said that it was in the interests of both the national firms and governments to develop measures against the present disintegration of markets and to ensure that the channels of international trade remain open for this purpose. He proposed the establishment of a group similar to the monetary group of ten, which would have to take the necessary steps to develop a workable balance between the interests of the multi-national firms and governments with a view to keeping international channels of trade open. To achieve this, according to Professor Kronstein, each of the participating governments should have a mode of operation similar to that of the central banks, in which anti-trust was one aspect.

Mr Steuer's paper approached the q[illegible] sidered by the Working Group [illegible] aspects of foreign direct investment i[illegible] Kingdom on a statistical basis. [illegible] importance of large companies in d[illegible]

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and analysed the problem of concentration and foreign direct investment; in addition, Mr Steuer gave some indications about monopoly power and host country gains from foreign direct investment.

Mr Copp in his paper stated the opinion of business in relation to differing attitudes to anti-trust, and complained about the unnecessary complexity of the anti-trust laws and about the long and cumbersome anti-trust procedures. He pointed to the antagonism between anti-trust and industry, and he favoured more consultation and more understanding between both sides. He advocated further a firm distinction between anti-trust laws governing the competitive conduct of industry and those laws relating to industrial structure. The first ones should, in his view, be clearly and precisely defined especially insofar as they provided sanctions; the latter should however be flexible.

We had a rather vivid discussion which focused on the following main questions. Does the multi-national firm present a real problem with respect to national economic policy as a whole and especially with respect to the application of the anti-trust laws? Second, the factual situation of the anti-trust authorities vis-à-vis the multi-national firm. Third, the difficulties in obtaining necessary relevant information for the application of domestic anti-trust laws. Fourth, in the application of national anti-trust laws could well be seen effective means to deal with possible detrimental effects of restrictive business practices of multi-national firms; and fifth, solution of possible conflicts between governments arising out of the application of national anti-trust laws.

Discussions showed a wide difference of opinion as to the possible benefits or detriments of the multi-national firm. It became clear, however, that the attitudes of national governments with respect to taxation, tariffs and other forms of protection of multi-national firms was an important element. It was acknowledged in the course of the discussion that the multi-national firm presented a special problem because this kind of firm was unlike the competitive individual firm of the past. Substantial difficulties for national anti-trust authorities to get relevant information became visible, and the possible remedies contained in national anti-trust laws were questioned as to their effectiveness. The proposed solutions were examined and there were some members of the working group who thought that a procedure following the EFTA model would have no success because of fundamental differences in the attitudes of the participating governments. It was doubted, even, that any relevant information could be obtained in such procedures, and it was pointed out that the GATT Resolution of 1960 which instituted such a procedure had no practical results. The possible reasons for that failure were analysed and proposals were made as to the level of such negotiations, as to the authority of the representatives concerned, and as to the manner of operation of the consultative body. Especially for the latter, some proposals made by Mr Copp were regarded as an operational procedure.

The points on which the discussion in the working group showed a rather broad consensus of opinion are the following. First, international firms are as such neither generally harmful, nor beneficial, to the national interests of the particular countries or to international trade, but may have, depending on the particular circumstances of each individual case, both beneficial and adverse effects. Evidence diverges as to the significance of the activities of multi-national companies for the benefit or detriment for national economies. But it became clear that the trend is the continuing growth of such firms, and that they will assume much greater importance in international trade and in the economies of many countries.

Second, there are a number of special features of international firms and their practices which need special attention. An example is where an international firm has strong market power in one country which can be supported by its activities in other countries. There may also be problems arising from the economic power which particular international firms may have on an international scale, for example, where vertical integrated international firms control a large part of basic material or essential technology for the production of a finished product.

Third, the special difficulties which international firms and their activities may present to governments in the application of domestic restrictive business practice law to such activities are mainly:

(a) governments may feel unable to deal satisfactorily with the domestic problem because of the fact that particular aspects of the international firms are outside their reach, for example, where relevant business documents are located outside domestic territory;
(b) where action which one country may wish to take against an international firm has an impact on other countries.

Fourth, these questions require further study internationally in appropriate international bodies such as OECD, but in addition to such studies international procedures of inter-governmental consultation and co-operation should be developed for the purpose of reducing the difficulties just described. It was held that such a procedure could be similar to the informal procedure developed in the European Free Trade Association in relation to complaints under Article 15 of the EFTA Convention. In developing this procedure, a similar approach could be taken as in the case of the International Copyright Convention, which is to enable countries to accept different degrees of commitment: a procedure with a possible progression between three levels depending on the individual country, moving from very loose co-operation and consultation arrangements at the lowest level, to more specific undertakings to exchange information to adopt conciliation procedures at the higher level.

Fifth, the working group recommended that the Council of OECD should instruct its Committee of experts on restrictive business practices to consider the establishment of a procedure of inter-governmental consultation and co-operation, dealing with any possible restriction of competition in international trade by multi-national firms, within the framework of OECD, and should formulate appropriate rules. The working group expected that the Governments of OECD member countries, through their representatives on the OECD Council, will give the necessary political impetus to this work.

4.2 The international firm and international aspects of policies on mergers*

H W Wertheimer

I THE DEFINITION AND IDENTIFICATION OF THE INTERNATIONAL FIRM

I.A Introduction

[illegible]

In the first section of this chapter, some sets of definitions of the international firm, as found in literature, are quoted and appraised.

The second section, which discusses the historical evolution of the international firm and the reasons for a firm becoming international, provides some insight [illegible] is important in order to understand the attitude of sovereign states towards the international firm.

I.A.I THE DEFINITION OF THE INTERNATIONAL FIRM

Although the history of the international company goes back to the early years of our civilization, it seems impossible to find a generally accepted answer to the question: What in fact is an international firm? The existing literature gives numerous definitions, all of them touching on one aspect or another. Roughly speaking, these definitions can be divided into two groups, one stressing more the geo- [illegible] host countries are taken into account in the firm's [illegible]

definitions used in the *Canadian Task Force Report*.[2] The same distinction as made in this Report has been adopted by Prof. Kindleberger.[3] Prof. H Perlmutter, stressing organizational features, makes the following distinctions:

The *ethnocentric* company: a company with strong headquarters and a centralized production and organization in the country of origin. All important decisions are taken by the headquarters.

The *polycentric* company · in this case, there is more decentralization than in the case of an ethnocentric company: here prevails more co-operation than subordination.

The *geocentric* company this type of company is characterized by a great independence of the foreign subsidiaries both from headquarters and from the subsidiaries abroad The headquarters only indicates the broad lines of the company's policy

The Canadian Task Force Report, stressing actual policies, distinguishes the following concepts

The *national* company operating outside the national territory, insisting on the primacy of the methods used at home, and even of the laws of the home country

The *multinational* company in a genuine sense, sensitive to local traditions, and respecting local jurisdictions and policies.

The *global* company, a company with such pervasive operations that it is beyond the effective reach of the national policies of any country and, in the absence of supranational policy, free to some extent to make decisions in the interest of corporate efficiency alone.[4]

Rolfe[5] mentions some more definitions of the international firm based on criteria such as the

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* In this paper the term 'merger' is used to describe either the pooling of control over the business activities of the enterprises involved, or the acquisition of control by one enterprise over the business activities of another, in both cases irrespective of the legal processes by which such results were achieved.

[1] H Perlmutter: 'L'entreprise internationale—Trois conceptions,' *Revue Economique et Sociale*, May 1965, 'Multinational corporations', *Columbia Journal of World Business*, Jan.-Feb. 1969.

[2] 'Foreign Ownership and the Structure of Canadian Industry,' *Report of the Task Force on the structure of Canadian Industry prepared for the Privy Council Office* (1968), p. 33. This report is commonly called the Watkins Report after its chairman.

[3] Ch P Kindleberger, 'The International Corporation', Lecture 6, in · *American Business Abroad, Six Lectures on Direct Investment* (New Haven and London, Yale University Press, 1969), p. 179.

[4] This type of company is hardly imaginable, if only for the reason that every international firm must conduct its business in some country and thus comes into contact with the public policy of that country's government.

More or less the same view is voiced by W Huppert, *Internationale Industriekonzerne* (Duncker & Humblot, Berlin, 1966), [illegible] 17.

[5] S E Rolfe, *The International Corporation with an F*[illegible] *and Responsibilities* (International Chamber of Co[illegible] pp. 11-16.

internationality of its ownership, management or turnover. Although these criteria may give an indication of the internationality of a firm they are not decisive: shares may be traded abroad for the single reason that the capital market at home is too small. On the other hand a firm with international activities does not necessarily have to float shares on foreign stockmarkets. Whereas management is national in composition, it may be international in orientation and its company largely involved in international activities. What percentage of total turnover should be international in order to label a firm as international, seems rather arbitrary.

Being fully aware that it is impossible to compress the pluriform phenomenon of the international firm into a short definition, since this is bound to be one-sided and will consequently present a distorted image of reality, I should like—in the context of this paper—to define an international firm as:

(i) a group of business bases subject to some degree of central managerial control;
(ii) operating within geographically diversified markets subject to different political, legal and cultural spheres; and
(iii) usually interdependent through some form of capital sharing.

I choose this definition, which comes close to Prof. Perlmutter's—who emphasized the geographical division of decision-making power within the international firm—because our attention focuses on the attitude taken towards the international firm by governments whose effective reach is geographically determined.

I.B. The evolution of the international firm

I.B.1 THE HISTORICAL EVOLUTION

The international company is not a phenomenon of our time only: the Phoenicians' investments in the tin mines of Cornwall, the German family banking operations of the Fuggers in the fifteenth and sixteenth century, the Italian bankers of the fifteenth century—the most renowned being the Medici Bank[6] which was also engaged in the textile industry—the East Indian companies of the seventeenth century, the slave-trading companies, and the Rothschilds of the eighteenth and nineteenth century, could all claim that title.

In more recent history there have roughly speaking been two waves of international direct investment as a reaction to diametrically opposed economic developments. The first took place during the crisis of the thirties, when a few scores of exporting companies tried to get around newly erected tariff barriers and quotas, and the second one arose since the end of the fifties. This second wave was facilitated by the increasing disappearance of governmental restrictions on trade, labour, payments and movements of capital between the major industrial countries and by the appearance of economic blocks that reduced restrictions on their internal relations even more. This liberalization of international exchanges was largely stimulated by the experience of steady economic growth, optimistic expectations about the future, and the improved techniques in the field of transportation and communication. A few thousand companies took advantage of these opportunities to internationalize their production, finances, manpower and eventually their research, so that they can now rightly be qualified as 'international'.

Since the mere quantitative extent of a development can lead to a qualitative change in the character of a phenomenon, it can be held that the nature of trade-relations between the nation states is changing because of the impact of the growing number of international firms.[7] Equally in the field of international contacts a change can be ascertained. The view of R. Vernon can be endorsed, who held that this evolution is not only quantitative but also qualititative in nature.[8]

It was not merely the quantum jump in international contacts that mattered, it was a change in the quality of those contacts as well.

Another qualitative development appears in the fact that nowadays many companies call themselves multinational, to indicate that they are no longer nationally oriented either in their business conduct or in their performance.

I.B.2 PHASES IN THE FIRM'S EVOLUTIONARY DEVELOPMENT

Service and manufacturing firms usually start as purely national firms and attain the stage in which they extend their functional activities abroad only after an evolutionary process. Extracting industries may become involved in international operations right from the start, their place of production not usually coinciding with the geographic locus of their consumer market if being situated in another nation state.[9]

Theoretically, the following phases in the evolutionary process of a manufacturing firm[10] can be distinguished:

First phase: a company with sales and production only within the home country (national stage).
Second phase: sales abroad directly to the customer or through middlemen (pre-international stage).
Third phase: creation of a sales office abroad by a manufacturing industry (incipient international stage).
Fourth phase: creation of assembling units abroad followed by integrated production units. Import substitution is their main purpose (outgrowing international stage).

6 *See* for example: R. de Roover, *The rise and decline of the Medici Bank* (Norton Library, New York, 1966).

7 At least a fifth of US exports of manufactured products go to the foreign subsidiaries of US corporations. 'The challenge of multinational business,' *Fortune*, 15 August 1969, p. 73.
8 R. Vernon, 'Economic Sovereignty at Bay', *Foreign Affairs*, Oct. 1968, p. 113.
9 Chr Tugendhat, *Oil, the Biggest Business* (Eyre & Spottiswoode, London, 1968).
10 It is not asserted that exactly the same development can be ascertained with the service or the extracting industries. Generally speaking, however, an analogous development may be discernible.

Fifth phase: creation of a fully operating company abroad with facilities for instance for development, marketing and sometimes research and financing (fully developed international stage).

A sixth phase could be added. taking-up of export activities from a host country. Here a distinction should be made between exports to third parties abroad and intra-company deliveries (the exporting international stage).

Along similar lines a distinction between various types of international corporations has been developed by Robinson.[11] He calls them respectively international firm, multinational firm, transnational firm and supranational firm—the latter under present conditions a purely hypothetical construction.

(a) *Evolution from first to second phase*

There are probably as many motives for entering the second phase—the taking-up of export activities—as there are firms that take this step, but the ones most frequently advanced can be summed up as follows:

The most obvious reason is that management expects its operations on the foreign market to raise the overall profits, either because of the better profit margins abroad, or for obtaining a higher total turnover. This expectation must, of course, be supported by the conviction that the company can meet local competition abroad because of certain advantages it has over the handicaps in entering foreign markets, e g. its lack of experience.

The need to increase sales: modern manufacturing techniques often necessitate enlarged production capacity, and the growing costs of increasing R and D work needed to meet the requirement of continuous product-innovation, can only be covered by income out of an increased sales-turnover.

In many cases such increased sales can only be found in other territorial markets, especially if the home market is small. The geographical diversification of selling operations reduces the risks inherent in business-operations and especially the dependence upon one single national market. As it is, a recession which as a rule does not occur in all national markets simultaneously, will affect the firm's cyclical vulnerability less seriously.

When one firm starts selling abroad, it spurs other firms to do likewise, since they are afraid their competitors might get a headstart in a potentially rich market. This may be called the proliferation effect.

In practice it is hardly possible to determine exactly which of these reasons has caused a certain enterprise to sell abroad or what is its relative importance in the decision-making process in which each of all the reasons involved is set against the disadvantages, the

(b) *Evolution from the second phase onwards*

The stages after the second phase all concern one form or another of the international firm. Many reasons can be enumerated to explain why a company enters into one of these phases. Here too, management will be responsible for weighing the numerous reasons involved. Since the evaluation of the various reasons depends on subjective judgement, and the time-horizon management has in view may vary considerably from firm to firm, the same reasons may lead to different policy decisions, while different or a different set of reasons may lead management to the decision to extend its operations abroad. In other words the

The most frequently advanced reasons are the following:

(i) Reasons in connection with cost price:

If a product is more expensive to make in the home country, taking into account transport, insurance and tariff costs, than when it is manufactured abroad, management has to consider the possibility of creating a production plant in the country concerned. It is quite possible that manufacturing costs in the home country are lower than those in the potential host country, but given the total of transport costs, insurance costs and tariffs the decision to establish manufacturing operations abroad may be perfectly rational. Thus some cost price considerations for moving abroad are:

Taking advantage of differences in a.o. technological development, labour potential, productivity and mentality, capital markets, local taxes, etc.

Reduction of transport costs because of covering shorter distances.

Avoidance of high or even prohibitive tariff barriers.

In a later stage of its international development a firm may want to start research activities abroad in order to use available specialized local talent.

(ii) Reasons in connection with the volume of sales:

A firm may fear that existing or future outlets abroad will not develop satisfactorily or will even be seriously impaired unless there is a readiness on its part to establish local sales offices and/or production units of its own. The reasons for these steps may be:

For the middlemen abroad the financial requirements for marketing the goods of his principal become too burdensome. The exporting firm has to step in itself if it wishes to expand its local outlets.

Before starting selling operations abroad on a really sizeable scale a firm wants to acquire first-hand experience of the special features of that local market: consequently it trial selling office of its own.

A firm wants to settle down in expanding local market

11 R D Robinson, *International Management* (1967), pp. 151–4.
12 Y Aharoni, *The foreign investment decision process* (Harvard University, Boston, 1966), Part III, pp. 245 ff.

The firm is capable of adapting itself quicker to all possible changes in that market if it has established a local subsidiary there.

A firm may want to follow important customers who are moving abroad in order not to lose them. This happens especially when the relationship between the firm and its customer is rather close and personal, for instance in the relationship between banking institutions and their customers.

The proliferation effect of keeping up with its competititors may also induce the firm to explore seriously the possibilities of establishing itself abroad.

A firm might be induced by persuasion or coercion of the local government to replace at least part of its exports to that country by local production.

This political pressure can only be effective if the market concerned is attractive enough. In many cases this attractiveness is created artificially by tariff barriers, favourable tax policies, etc.

In a later stage of its international development a firm might be pressured by the host country's government to expand its already established subsidiaries so as to comprise other activities such as research facilities, or even to take part in the export efforts of the host country.

A firm may start R and D activities abroad because it wants to adapt itself better to the specific requirements of the local market or some important customer, for instance a host government.

In countries whose economies are being integrated into a common market, international enterprises have opportunities to disperse and specialize their production over the participating countries, thus obtaining a better international division of labour, larger production runs and a better utilization of the economics of scale. Component-part production can be centralized[13] and an intensive intracompany traffic develops. As long as increased transportation costs and handling charges do not exceed the decreased cost price, it is a paying proposition.

A firm may feel its growth impaired by the impact of domestic legislation, for instance fiscal or anti-trust legislation. This situation may prompt it to seek expansion abroad.

(iii) Reasons in connection with the risk factor:

The necessity to reduce the risks inherent in business enterprise is an integral part of our modern society with its ever increasing technological progress and shortening profitable life-cycle of products. The use of modern techniques often implies that enterprises are becoming more capital intensive and consequently more and more inflexible. As a result the risks of businesss operations become correspondingly greater and the drive towards safeguarding the continuity of input and output more and more pressing. To avoid exclusion from its customers' and its suppliers' markets, a firm is often forced to respond by forward integration in the direction of distribution at national and international level, and backward integration in the direction of raw materials abroad.

To counter inflexibility and to protect itself against the fluctuation arising from recessions—which hardly ever occur simultaneously in various countries—and the ensuing underemployment of its production resources, a firm may decide to invest abroad.

In order to reduce the risks of political and social disruptions corporations may spread their activities over more than one country.

In some respects the risk factor reasons are related to the cost price argument.

The state of a national economy is often reflected in the prevailing rate of interest. The riskier the economy the higher the prevailing rate of interest for obtaining funds. A firm may seek to move to those local markets where the rate of interest is the lowest, since capital is often one of the major factors of production.

On the other hand these higher costs should be balanced against the opportunities for higher profits in such an economy.

When a firm is engaged in risky operations, it will have to pay more to obtain capital than others. If the risks could be diminished by spreading them over several countries, capital may become cheaper to obtain. This may lead a firm to go international.

It should be reiterated that all these reasons are in no way of a compelling nature. Conservative management may decide, notwithstanding all possible favourable opportunities, to play safe and to stay at home. The costs of operating at a distance[14] may be considered too high. On the other hand, the reasons which in fact motivate management's decision to go abroad are very differentiated.

I.C The organization and the location of the decision-making power

This section will be concerned mainly with the forces arising in an international company that tend towards more autonomy for the subsidiaries abroad in the decision-making process, or that make for more centralization. Naturally this subject does not lend itself to an easy generalization either. Here too a general blueprint cannot be provided.

In itself it is a normal thing for top management of a fully developed international enterprise to confer more autonomy and to delegate authority in order to give the best chances to initiative and flexibility. The realization of this idea differs from one enterprise to

13 Rolfe (op. cit., p. 40) holds that this form of 'complementation' is also feasible when regional integration is lacking. This is, of course, true but less easily practicable and rather hazardous.

14 Ch P Kindleberger, 'The Theory of Direct Investment', Lecture 1 in *American Business Abroad, Six Lectures on Direct Investment* (New Haven and London, Yale University Press, 1969), p. 12.

another for subjective and objective reasons. The subjective reasons find their basis in the mentality of top management (autocratic or democratic leadership) and in the mentality and sociocultural background of

[illegible]

modern techniques of telecommunication, 'exception reporting' makes it possible to decentralize more and more.

Significant economic factors governing the organizational structure are partly determined by:

(i) Factors pertaining to the interdependence and cohesion of the various parts of the international corporation, for example:

(a) The need for unity of action towards the outside world.

Centralization is mandatory where sound company policy dictates unity of action, e.g. in order to maintain or to create a specific image or identity, or in order to strengthen the bargaining position of the corporation, for example in negotiating licensing agreements on patents and know-how with third parties

(b) Research and know-how in manufacture and marketing acquired by the various subsidiaries will be communicated to headquarters. As this knowledge accumulates together with the knowledge headquarters has acquired from its own activities (being more extensively staffed than its subsidiaries), headquarters will increasingly evolve into a clearing-house of knowledge in the corporation This aspect tends to point to a unified implementation of overall company techniques even under a highly decentralized corporate structure

(ii) Factors connected with the products and production processes of the corporation involved:

(a) In relation to the corporate structure of the international corporation, for example:

When there is an international dispersion and specialization in the production processes for products sold in various local markets entailing intra-company deliveries, a need arises for central planning and co-ordination, which in most cases leads to a more or less centralized structure.

When the subsidiaries' production units abroad are interdependent, e g. in respect of component manufacturing, the need for common standards of production and quality control also necessitates a centralized organization.

The greater the importance of research and other functional activities in the total activities of a corporation, e g. because the products manufactured are technically complicated, the more central planning and co-ordination in those fields is indicated to prevent unforeseen overlapping efforts.

(b) In relation to other factors, for example.

If a corporation is manufacturing products particularly designed to be supplied to governmental bodies, e g. telecommunication equipment, a foreign subsidiary dependent as it is on the host government, may obtain a greater autonomy.

(iii) Overall factors due to the operations of the international corporation being affected on various national markets, for example:

(a) The need for the foreign subsidiary to adapt itself to the local environment may contribute to its autonomy.

(b) The greater the importance of the foreign subsidiary's sales turnover in relation to the total sales turnover of the corporation, and

(c) The more the rate of return of the subsidiary abroad exceeds the average profitability of the whole corporation, the more this may contribute towards the standing of the local manager in the corporate structure.

(d) When a foreign subsidiary is based in an interventionist economy this may increase its autonomous status.

(iv) Factors due to temporary situations deviating from normal conditions, for example

When a new subsidiary abroad has been established with inexperienced local management, central control is indispensable for the time being

When for some reason or another the sales turnover of profits of the foreign subsidiary falls short of expectation, central control tends to become stronger.

Although this list of centrifugal and centripetal forces is not exhaustive, it gives an impression of the kind of forces at work The decisive factor for central control or autonomy here again is, of course, the mentality and attitude of top management towards the executives in the different countries.

The extremes of centralization and autonomy that can be met in a corporate structure are on the one hand a remote control relationship, i e. where the subsidiary has no independence and operates like a branch office, and on the other hand an arm's-length relationship, i e. where independence extends up to the limit of the strategic objectives of the corporation In this structure there is a maximum of autonomy for the foreign subsidiary, and the only more or less centralized functions are to be found in the field of co-ordinating the planning of new investments and the financing of the subsidiary.

Now that the different forces tending in the direction of centralization or autonomy have been spelt out, it seems reasonable to wonder what actually is

[illegible] is a shift according to stages of operation, times and circumstances.

When a company starts investing abroad [illegible] control is often needed; when the company [illegible] or less settled down in the host countries [illegible]

a tendency to grant autonomy to the subsidiaries. Insight at close quarters into the needs of the local market can best be obtained on the spot by the management of the subsidiary.

In a later stage the need to centralize manifests itself again when that subsidiary is integrated in the global company planning for internationally dispersed and specialized production as well as for international marketing. This need for centralization may take the form of a real central control, but also a structure of mutual co-ordination or a federal set-up can be chosen. Export operations to third parties abroad from various subsidiaries located in different countries will also call for a certain central control from headquarters and co-ordination between all the subsidiaries involved.

Apart from the overall position of the corporate structure, the continuous charges in internal and external circumstances may affect the organizational pattern of the corporation—in that they may have a specific and possibly different impact on centralization or autonomy—where the various functional activities of the firm are concerned, such as research, development, manufacturing, marketing, financing, etc. There may even be a difference of effect on the various subfunctional activities, such as basic research and applied research. Top management may have more confidence in delegating authority in one sector of its activities or have more trust in the abilities of the executives in a particular country, but may want to retain strict control in another sector or country. This means that besides an overall trend there may be opposite subcurrents underlying corporate functional, subfunctional and geographical activities. In other words, the dichotomy of centralization or decentralization is too rough an indicator to describe the operational set-up of a corporation if no mention is made of the specific functional and geographical activities that are meant.

The aspects discussed are of particular importance when the attitude of the nation state towards the international firm becomes the subject of a closer analysis. The attitude of the nation state is often not or perhaps hardly ever governed by the general degree of centralization or autonomy in an international firm. In most cases this attitude is determined by the degree of autonomy which the local subsidiaries enjoy in certain specific fields of entrepreneurial activity such as financing, research, investment policy, export activities, etc. It is precisely those fields of activity in which the centripetal forces are usually strongest—and thus remain under the control of headquarters—that the governments are most interested in.

II ATTITUDES OF NATIONAL GOVERNMENTS TOWARDS A FOREIGN DIRECT INVESTMENT[15]

The economic handbooks mention numerous reasons why a national government might react positively or negatively towards foreign direct investments of international firms. When analysing all these reasons, one would come to the conclusion that the most important economic determinant for the nation state's attitude is, whether the foreign subsidiary contributes to the political-economic aims of the nation or not. In most countries[16] such aims are balanced growth, full employment, stable prices, balance of payments equilibrium and an equitable income distribution. However, considerations of economic policy do not stand alone. In addition, there are more or less politico-psychologically determined factors that touch upon the question whether national economic independence and national sovereignty is held to be increased or decreased by the creation and the anticipated conduct of a foreign subsidiary.

The attitude of governments towards international companies, therefore, will depend upon considerations of political economic as well as politico-psychological factors. From the same economic facts governments often can draw inferences in a positive as well as in a negative sense, depending on which economic aspect they wish to prevail. To a large extent the politico-psychological considerations determine which economic argument should be given most weight and consequently govern the attitude governments actually adopt. In other words politico-psychological considerations are often presented under the guise of economic reasoning.

II. A Positive attitude of governments towards a foreign direct investment

As far as the capital-*exporting* transactions are concerned, the government's attitude will be largely determined by the actual position of its own economy and of its balance of payments. If the country has a permanent surplus on its balance of payments, capital-exports for productive purposes will quite definitely be appreciated as a positive contribution to a reduction of this surplus.

It has been asserted that a government's positive attitude towards investments abroad is also governed by more political considerations since it might use these private investments as an instrument to exert a certain influence on the internal policies of the potential host country's government.[17] On the other hand the government will not fail to accord diplomatic protection to the international firm if the latter is exposed to discriminatory treatment, like expropriation, by some foreign government (cf. the Barcelona Traction case.[18]) This possibility of falling back on

15 In this paper the term 'foreign direct investment' denotes the establishment by a firm of its own operational facilities abroad, quite appropriately termed 'grassroots operations' by Ch Tugendhat (*The Financial Times*, 7 October 1969).

16 In the USA the maintenance of effective competition is explicitly accepted as a sixth objective.

17 This is an argument frequently used by the Latin American countries to protest against the influence of US business in their countries.

See in this connection: J Gerassi, *The Great Fear, The Reconquest of Latin America by Latin Americans* (The Macmillan Company, New York, 1963).

18 *The Barcelona Traction, Light and Power Company Ltd.* (*Belgium v. Spain*), Case No. 22 A/B/C, *ICJ Yearbook 1960–61*, p. 87, 1964–5; pp. 82–7, 1965–6; p. 91, 1966–7; p. 86, 1967–8; p. 84, 1968–9; pp. 99–100.

'The trial, which has dragged on for more than a decade—the date of registration being 23 September 1958—was finally

assistance from its government may be a valid reason for the international firm to show its allegiance to the home country.

The other side of the coin, i e. the attitude of govern-

they adopt a very positive attitude towards foreign direct investments. For the developing countries such an attitude seems evident, but also in our more prosperous western society there is hardly a country not in favour of capital-importing foreign investments, at least in principle. The way in which this principle is put into practice, however, differs from country to country and from investment to investment, depending upon quite a number of factors. The positive factors will be dealt with here.

For political reasons a country will adopt a positive attitude towards foreign investment, in so far as it feels that this investment will contribute to its national sovereignty and national economic independence. It may be held that these considerations prevail in developing countries, where they find their reflection in the prestige projects. But it may be also submitted that these motives are not limited to these countries alone.

In the economic domain the positive attitude of national governments towards foreign investment is in most cases determined by what these governments expect the investments to contribute towards the achievement of the aims of national social-economic policy they want to pursue. When the reasons for considering foreign investment as conducive to a country's social-economic structure are advanced, reference is often made to these national social-economic objectives. The Canadian Task Force Report[19] can be cited as an example when it states that:

> In the important area of economic growth there is a substantial element of harmony in the interaction of the multinational corporation and the host country. The creation of economic growth is a major goal of the nation-state. It is likewise a major consequence of the global operations of the corporation. Direct investment as a package of product, technology, management, capital and market access brings with it large potential benefits for the host country; certainly their benefits are larger than are imagined by those who conceive of foreign investments as being simply a capital flow.

and

> Another most important benefit that typically accrues to the host country from foreign direct investment results from the effects on its foreign trade. Direct investment in resource industries is typically export-creating, while direct investment in manufacturing can be import reducing, hence, direct investment does not only create an improved employment-situation and an augmentation of the standard of living, it also improves the balance of payments of the host country.

Raymond F Mikesell[20] puts more emphasis on the strengthening of the industrial and managerial know-how aspect when he states:

> The major impact of direct foreign investment on the host country must be measured in terms that go beyond balance of payment accounting and consider a broad range of activities of the foreign enterprises themselves. Of greater importance than the accounting value of the resources transferred are the intangible resources such as skills, techniques and entrepreneurship which accompany direct private investment.

It is these skills, techniques and entrepreneurship that raise the productivity of the labour force and thus

statements are:

- diversification of the national economy of the host country;[21]
- stimulation of regional development in the host country;[22]

> 'The presence of foreign capital may not only raise the productivity of a given amount of labor, it may also allow a larger labor force to be employed. This may be most relevant for heavily-populated poor countries where the population pressures are taken out through unemployment or underemployment in the rural sector. If, as is frequently contended, a shortage of capital limits the employment of labor from the rural sector in the industrial sector where wages are higher, an inflow of foreign capital would make possible more employment in the advanced sector'

> His argument holds true not only for less developed countries, but also for certain OECD countries or parts of these countries.
> 'Much of the contribution of international investment itself has been indirect, through acting as carrier for the transmission of technology and administrative capacity and through the migration to sparsely settled areas which it has facilitated.'

- increased competition and thus improved allocation of the factors of production on the market of the host country;
- the foreign investor usually contributes more to the host country's economy than he is able to take out because of the incidence of taxation;[23]
- the national capital market is relieved when an international firm attracts foreign funds for its investment, while a national firm would have to borrow on the national market

This is not a definitive summing up of all the arguments that play their role in determining a government's positive attitude towards foreign investment. It does, however, at least give an impression of the kind of arguments used and provides an insight into the way a government's attitude is governed by the correlation between the social economic goals it pursues and the effects of foreign direct investment on the state's economy.

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concluded on 5 February 1970. The Court in its final decision dismissed the claim of the Belgian government holding that it was not qualified to act on behalf of a company established in Canada even if its shareholders were of Belgian nationality.'

19 Watkins Report, op. cit., pp. 36–8.

20 Raymond F Mikesell, *U S Private and Government Investment Abroad* (Oregon University Press, 1962), pp. 6–7.

21 G M Meier, *International trade and development* (Harper & Row, New York, 1963), p. 94.

22 B F Hoselitz, *The progress of underdeveloped areas*, University of Chicago Press, 1952.
'America's aims and the progress of underdeveloped countries,' by Jacob Viner, pp. 184–5.

23 S E Rolfe, op. cit., p. 127
J H Dunning, *The Cost and Benefits of Foreign Direct Investment to the Investing Country: The UK Experience*, University of Reading Discussion Papers in Economics. No. 9, September 1968. The argument holds true in so far as prices used in the national accounts of the host country do not deviate too much from prices.

II.B Negative attitude of governments towards a foreign direct investment

In this context the division between capital exporting and capital importing transactions remains relevant. Although the Reddaway Report[24] indicates that at least for the balance of payments of the capital *exporting* country it will be profitable in the long run to encourage foreign direct investments, most governments' attitudes probably will be more influenced by their short-term effects upon the balance of payments, the situation on the capital market, the danger of brain drain and the employment situation, because in fact these short-term effects can be better evaluated and are more pressing for the nation's actual economic position than long-term anticipations.

The negative attitude of governments towards capital *importing* transactions involving foreign direct investment in their countries may equally be determined by economic factors. In most cases the five objectives of national economic policy are at stake here too. Although the correlation between these social economic aims and foreign investment often calls for a positive instead of a negative governmental attitude, negative economic aspects may equally be connected with foreign investment. The government concerned may be afraid of too powerful competition for the national producers, entailing perhaps unemployment and market-disruption. Equally, the complaint is often heard that the international enterprise may drain the local capital market. Also mentioned is the stream of profit-earnings out of the country and the chance of disinvestment when profits become difficult to make, with a commensurate burden on the balance of payments at unexpected and possibly inopportune moments. This may entail decreased economic growth and unemployment. By intra-corporate transfer pricing the international firm may get around exchange controls or restrictions on profit transfers and repatriation of capital and consequently worsen the balance of payments difficulties.

Politico-psychological considerations also play their role here, often unrecognizable since they are presented as economic arguments. However, the complaint most frequently heard, equally with an economic background, is that the decision-making process takes place beyond the effective reach of the government. Decisions may therefore ignore the policy of the host country, with the potential danger that they will not be in the host country's national interest.

In order to ensure as far as possible that their interests are better represented, the host governments sometimes insist that international firms appoint nationals to the board of local subsidiaries. Legislation to this effect exists for instance in Finland, Denmark, Sweden and Switzerland. Such a situation does not, however, necessarily guarantee complete consonance between the interests of the host country and the objectives and interests of the international firm. The conduct of that firm may also be determined by legal and extra-legal obligations imposed by the government of its home country as well by conflicting demands of other host countries. These may be so compelling that central management will have to give in.

Numerous politico-psychological considerations often find economic expression in the following complaints:

Although the influx of senior personnel from the parent provides management skills of a high quality, the ease with which managerial and entrepreneurial skills can be imported may reduce incentives to improve these skills in the host country.

Although capital inflows increase aggregate saving and investment and the rate of economic growth, the institutional development of a national capital market may be inhibited and the range of choice facing the investor reduced.[25]

Although the direct investment provides easy access for the subsidiary to the technology of the parent, the latter is not necessarily the appropriate technology for the host country and the potential to become a leader rather than a follower may be diminished.

Although foreign affiliation may provide an assured market for the subsidiary's output, particularly of raw materials and semiprocessed goods, the resulting 'prices' if the taxation authorities do not ensure otherwise, may not bring in the maximum benefit for the host country.

Although, in manufacturing, the subsidiary gains access to the trademarks for tested products and the residents of the host country are offered the latest consumer goods, the subsidiary may become simply an appendage of the parent, copying products for the domestic market and, in the unlikely event it is efficient, restrained from exporting, while the absence of distinctive national products may limit national advertising and impede the development of national media in the host country.

A considerable part of the international flow of money, goods and services takes place within multinational enterprises. When international transactions are effected between parties whose relationships are long-term and organic in character, the regulatory capabilities of an intervening state inevitably decline.[26]

The fear of a balance of payments disequilibrium if imports and dividends to be paid abroad exceed the amount of exports and possible royalties collected from abroad.

The international character of the firm is said to involve the potential danger that some day it may claim its right to stop production and remove it abroad. This may not only lead to unemployment and economic disruption but also to a serious deterioration of the balance of trade.

Through speculations by means of forward transactions and by incurring and moving up large debts, international firms can aggravate the situation when the local currency is in trouble.

In many cases foreign investment is concentrated in a few industries within the host country. The

24 W B Reddaway in collaboration with S J Potter and C T Taylor, *Effects of UK Direct Investment Overseas, Final Report* (Cambridge University Press 1968), p. 338.

25 Watkins Report, op. cit., pp. 38–9.

26 Raymond Vernon, 'Economic Sovereignty at Bay', *Foreign Affairs*, October 1968, p. 119.

governments concerned may fear that this could present a severe set-back for their efforts to achieve economic independence. When foreign investments are going to penetrate into the key sectors of the national economy they are often bound to meet [illegible] positively to the national research and development effort, and when it does, that continuity is not ensured.

Summarizing, it could be said that most of these complaints concern conditions that may hamper national authorities in the implementation of their economic policies. These complaints will become all the more serious the more the country, or the industrial sector, where the international firm wants to establish itself has already been penetrated to a high degree by foreign investment.[27]

Against these complaints of the host countries it has often been argued that these fears are unfounded since the facts demonstrate that in practice the international firm does not or hardly ever adopts the line of conduct feared by the host country. Such arguments, although they may be true in themselves, are [illegible]

In this chapter the determinants of the positive and negative attitudes of national governments to- [illegible] positive as well as the negative aspects inherent in that investment.

It is submitted, however, that on balance governments consider the economic aspect of foreign direct [illegible] the foreign investment is made, for example by the creation of a subsidiary, the taking-over of an existing company or the setting up of a joint venture.

III INTERNATIONAL MERGERS

III.A. Kinds of international mergers

The term 'mergers' as used in this paper covers amalgamations as well as acquisitions or takeovers. Amalgamations and acquisitions or takeovers are all species of the genus co-operation between companies. They differ as to the degree in which the partners maintain their independence. Amalgamations are generally characterized by the fact that both partners give up their absolute independence and retain a certain relative independence—at least at the outset—in so far as they take part on an equal footing in the formulation and realization of the policy of the consolidated entity. In principle a takeover will lead to a more or less complete subordination of the policy of the acquired enterprise to the policy of the acquiring company.

In practice an amalgamation or a takeover can be performed in various ways. Some parts of the companies concerned may be put together while other parts may be kept separate. Practice therefore invalidates formal distinctions. For some companies with a more or less federal structure the picture in regard to takeovers and amalgamations is more complicated in that corporate headquarters do not enforce a centralistic policy vis-à-vis the—acquired—foreign subsidiaries. Because a complete subordination of the acquired enterprise does not occur, the latter will probably look upon the whole operation as an amalgamation, while corporate headquarters may consider it as a takeover. A merger is international in nature if consummated between companies located in different nation states.

In the next chapters the terms 'active' and 'passive' merger will be used. The distinction from the point of view of a nation state is the following:

An international passive merger is the acquisition at home of a domestic company by a foreign company.

An international active merger is the acquisition abroad of a foreign company by a domestic company.

This distinction has some relevance not only since it governs to a large degree the attitudes of national governments towards international mergers, but also for its ensuing legal implications. Amalgamations contain elements of passive as well as of active mergers.

III.B The firm's reasons for entering into an international merger

Whatever reasons may be enumerated in this section they do not compel management to undertake a merger. The managements of the acquiring and the acquired companies are in a way free to decide whether they should merge or not. Each of them may reach a conclusion for different reasons. Even in one and the same board of a company the members may be motivated by a different set of business and 'personal' reasons for agreeing to a merger.

Since the reasons to undertake international mergers are in most cases not clearly distinct from the reasons for merging in general, the latter reasons will be dealt with mainly, while specific reasons for international mergers will be mentioned where necessary. The reasons for merging are numerous and each merger apart is motivated by a set of reasons peculiar to that specific merger. It seems useful to divide these numerous reasons into two main categories, viz. technological and economic reasons, and psychological reasons.

A certain number of economic and [illegible]

[27] See in this context J Dunning, *The Role of American Investment in the British Economy* (PEP, London, 1969), p. 160. Developed countries with an important degree of penetration of foreign investment include Canada, Australia, South Africa and the United Kingdom.

reasons for merging have repeatedly been mentioned.[28] In most cases these reasons come under the heading of 'economies of scale',[29] that is to say economies in the field of production and in marketing. Well known are the economies of scale in the field of production, such as more efficient production methods, more optimal use of the combined research facilities, better possibilities for planning, a more optimal range of products produced, better opportunities to employ a more differentiated management potential and staff, more efficient employment of capital. The economies in the commercial field are less often mentioned but are none the less also frequently decisive. Such economies include a more optimal use of the sales offices, better possibilities to develop a market analysis and strategy and more effective means of supporting the launching of new products. Especially in the case of international mergers when penetration into new markets abroad is at stake the commercial advantages become most obvious since it is essential for the acquiring company to make the fullest use of the marketing experience and techniques of the acquired foreign company in order to operate there.

Other economic reasons for mergers, that have no direct relationship to economies of scale, are fiscal motives; the desire to gain a better access to capital markets; the desire for international diversification, and for the acquired family-company the assurance that it will remain in existence when the actual owner manager has retired, no successor being available.

Additional economic reasons for international mergers could be that merging has the advantage of conferring local colour—if the identity of the acquired company abroad is maintained—and provides new local business relations and knowledge about local habits and the behaviour of customers as well as access to the local labour market.

Many of these reasons, which apply to active as well as to passive mergers, do not in themselves create an absolute necessity for merging, because the aims can often also be attained through direct investment; for instance some economies of scale in production and marketing can also be realized just by increasing production and by enlarging market-shares by one's own operational facilities.

When reviewing, therefore, the specific technological and economic reasons for merging, the considerations which tip the scales in favour of merging should be set off against the other alternative, e.g. growth by direct investment. An important technological and economic reason for merging is that it may be seen as a quicker, less risky and in many cases even a cheaper device for achieving the objectives set by top management than direct investment.[30] A merger, apart from yielding quicker results, often also entails fewer risks. A direct investment requires a build-up period of often several years before the investor can reap its advantages. The build-up period for mergers may be shorter and consequently reduces the risks of failure. In fact during a longer build-up period it is more likely that unforeseen events will happen. The economic, social or political environment can change to such an extent that the investing company may have to decide to stop its operation, entailing the loss of all its investments already made.

These advantages are set off by drawbacks, principal among which are the difficulties incidental to the integration and harmonization of the operations of the acquired firm within the acquiring corporation. An important reason why a comparatively large number of mergers are not successful may be the discrepancy between the ex ante evaluation of these difficulties when the merger decision is taken and the ex post realization of the adaptation process. Thus the criticism of mergers for their recurrent failure may often be aimed not so much at the device of the merger itself as at the imperfect foresight of managements or the shortcomings in their organizational ability to integrate the operations of the acquired firm into the whole.

Other reasons for mergers may be that they provide the only feasible method to attain a certain goal. Important in this context are the so-called 'foothold mergers'. These mergers are designed to enable the acquiring firm to break into new product markets or new geographical markets. The geographical foothold merger may be a specific device for an international firm to penetrate into new markets abroad which it could not enter without taking undue risks, or could not enter at all on the strength of its own resources, either because the prevailing market conditions seriously hamper or prevent the entry of foreign newcomers, or because governments show a preference for local firms[31] as is seen for instance in the case of public tenders or defence contracts.

Besides commercial foothold mergers, technological foothold mergers can be distinguished. In acquiring a company possessing the necessary know-how and skill a firm is enabled to bridge a technological gap and thus to enter new fields of activity. In this way international mergers can act as carriers for the dissemination of knowledge and technology across the borders. A third kind of foothold merger is the financial one. It enables the merging enterprises to enter the capital market where they can raise the necessary funds to finance their operations.

Another motive for resorting to a merger as the only available device to achieve a certain objective springs from protective or defensive considerations, as against those considerations that relate to the positive development of the strategy of the acquiring firm. The firm in question fears that some event may disturb the equilibrium of the market and have a detrimental impact on its position. To forestall such an event or to protect itself against its consequences, a firm then sees a merger operation as the only remedy.

In other words, protective mergers are designed to

28 Nicholas Stacey, *Mergers in Modern Business* (Hutchinson, London, 1966), pp. 43–4.
29 J Weston, *The role of mergers in the growth of large firms* (University of California Press, 1963), p. 85.
30 E T Penrose, *The theory of the growth of the firm* (Basil Blackwell, Oxford, 1959), pp. 156 ff. esp. pp. 179/80.
For a contrary opinion: I M Stelzer, *Hearings on Economic Concentrations before the Subcommittee on Antitrust and Monopoly*, US Senate, Part I, p. 181, and J. Kitching, 'Why do mergers miscarry', *Harvard Business Review*, Nov.–Dec. 1967.

31 J N Behrman, *Some patterns in the rise of the multinational enterprise* (University of North Carolina at Chapel Hill, 1969), p. 15.

minimize anticipated losses. A typical example of a protective merger is the one inspired by the intention to pre-empt a merger or takeover by a competitor, by merging beforehand with the company the competitor had in view. Such mergers can also occur in the international field.

Mergers may be entered into for foothold and protective reasons at the same time. Under this heading come:

Mergers arising from the desire to guarantee supplies of raw materials or sales outlets at home and abroad, leading to vertical mergers with the expansion of activities upstream and downstream (forward and backward integration).

Mergers, as often urged, between European corporations, preferably across the borders, as a countervailing power to meet American competition in the European Common Market as well as in the world markets.

Mergers or joint-venture operations designed to enable firms to keep pace with developments in markets showing a fast rate of expansion and rapid change, where it is hardly possible for firms to follow this evolution by internal growth without losing ground.

Conditions, of course, do exist under which it is feasible for an international firm to obtain a foothold on a market abroad or to protect itself against market disturbances by means of direct investments. In those cases a merger is an alternative method for the same objectives and may be preferred if it is thought to be a quicker, less risky or cheaper device.

Mergers motivated by economic and technological considerations are mainly designed to ensure the

[illegible]

continuity of the firm, a frequent object of a merger is to maintain the firm's relative position in the commercial, technological and financial field.

The psychological reasons for merging have been given quite some publicity lately, since the publication by *J Bossons, K J Cohen and Samuel R Reid of their* study on mergers and growth on the stock-market.[33]

These three economists wanted to demonstrate that the real motive for merging in most of the big companies is the central management's striving after personal power (and higher income). Whether this personal involvement of management actually plays such a pervasive role in many mergers is difficult to ascertain. It would seem that a number of conditioning factors influence the existence and extent of such motivation, e g. stock options, tax amenities, etc. It is a subject that certainly needs closer study. It should not be discounted altogether that the 'empire-building' urge[34] of management to create an extensive and powerful firm can also be inspired by the desire to indulge in a sentiment of social recognition.

[illegible]

international, but above all national, mergers going through Europe in the last decades. This wave, often stimulated by the European governments, is *partly caused by the conviction that competition with* American companies can only be survived by big enterprises, and partly by the so-called proliferation effect in that one merger provokes, as it were, 'contagiously' the creation of another merger.

As a conclusion it can be held that a great variety of economic, technological and psychological reasons govern the motivation for entering into a merger. Some reasons can be specific to mergers alone, but others can be equally valid to mergers as well as to direct investment. Which reason or which combination of reasons was actually decisive in an individual merger operation can only be ascertained from a case-by-case analysis, if at all.

Up to now the private aspects of a merger have been dealt with. The attitude of governments towards mergers will be determined by the balance of the social costs and benefits of the merger. Private benefits like greater efficiency, expansion, ensured continuity, higher exports will certainly be entered on the credit side of this balance, but there are quite a number of other—positive and negative—considerations, often non-economic factors, that also play their role.

When evaluating the pros and cons of a merger the nation state takes as its criterion the national public interest. In a way this points to a certain analogy with private enterprise that is mainly concerned—but not exclusively—with the private aspects of a merger. The nation state's view is equally parochial in outlook in that its evaluation of an international merger is confined—but not exclusively—to the public interest of the nation state itself. Whether an international merger might be to the benefit of the community of nations lies beyond its realm.[35]

[32] Kindleberger, 'The Theory of Direct Investment', Lecture 1, op. cit., p. 9.

[33] J Bossons, K J Cohen and S R Reid hold that in the USA, growing from within may pay off faster. In their opinion this is proved by the fact that out of all the American companies examined (478) the companies involved in mergers only showed a rise in their stock prices of 307 per cent between 1951 and 1961, while the companies not involved in mergers displayed a rise of 680 per cent in the same period. This could establish the presumption that the first category was less profitable because of their involvement in mergers.

Statement of S R Reid for the Sub-Committee on Anti-trust and Monopoly, US Senate, *Hearings on Economic Concentration*, Part 5, p. 1914 ff.

Their study does not seem conclusive since the sample was small and it could not be established that the merging companies would have been better off without a merger.

P Sargant Florence comes to the same conclusions as Bossons e.a. on management's conduct for the UK industry.

Hearings on Economic Concentration before the Sub-Committee on Anti-trust and Monopoly, US Senate, Part 7, p. 3574.

Equally: Lewis and Stewart, *The Managers. A new Examination of the English, German and American Executive* (Mentor Books, 1961), Chapter 9.

[34] E T Penrose, op. cit., pp. 186–9.

[35] Equally, Ch P Kindleberger, *Hearings on International Aspects of Antitrust*, Subcommittee on Antitrust and Monopoly, US Senate, Part 1, 27 April 1966, p. 153.

IV ATTITUDES OF NATIONAL GOVERNMENTS TOWARDS INTERNATIONAL MERGERS

As already stated in Section III of this paper, many reasons inducing a company to enter into international mergers are similar to those that lead to direct investments abroad. Mergers, however, are in some cases quicker, more certain and often cheaper expedients for reaching the desired objectives.

Positive attitudes of the national governments towards international *passive* mergers may be prompted by analogous motivations. Negative attitudes of the governments are frequently dictated by economic objections to changes in the competitive environment of the industry that would result from the new situation created by the merger. Other reasons for a negative attitude are often more difficult to evaluate, because of their usually politico-psychological character, differing from country to country.

Governmental attitudes—positive as well as negative—towards *active* mergers, are probably governed to a large extent by economic considerations. A distinction between short-term and long-term influences can be made here.

IV.A Positive attitudes of national governments towards international mergers

IV.A. I INTERNATIONAL PASSIVE MERGERS

It is a well-known fact that governments, in principle as well as in the great majority of the actual cases, adopt a favourable attitude towards local mergers concluded with foreign companies (the international passive merger), although it may be that they often prefer a special form of merger, viz. the joint venture. Everywhere in our industrial western society a positive policy is shown towards these international mergers, particularly by international organizations like the European Economic Community. In this connection statements can be quoted from the European Commission:[36]

> Concentrations which increase productivity will be all the more desirable if they cross the old borders and thus promote an integration of markets. In general one should adopt, therefore, a positive attitude towards such concentrations.

and also from the European Council of Ministers:[37]

> In practice the expansion of enterprises across the national borders will necessitate international concentrations. These entail the advantage that from the outset already an existing base can be utilized so that the pursued objectives can be attained more rapidly. There seems an urgent need for such enterprises to be established in the framework of the Community, for they would provide not only important economic advantages . . . but moreover they would not evoke the same psychological problems as concentrations of the same size constituted in the mere national plane.

The European authorities have not restricted themselves to platonic declarations, they have also proceeded to actual proposals such as those calling for the creation of a statute for a European Company,[38] for a directive concerning common fiscal regulations applicable to mergers between companies from different member States, and for a directive concerning common fiscal regulations for parent companies and subsidiaries from different member States.[39]

All these proposals are designed to facilitate intra-EEC mergers. A similar positive position does not seem to be held so unanimously towards mergers of nationals from third countries—in particular the USA—with nationals from the member States of the EEC.

The positive attitude of national governments towards passive mergers is prompted—as already appeared in the European Council's statement—by the consideration that the advantages they anticipate from foreign direct investments will be reaped more rapidly through international concentrations. The country often derives quicker advantages from the increased technological knowledge, the introduction of new techniques, better efficiency, availability to the public of better or new products, higher rate of employment, improved management performance, better ability to meet foreign competition, better capital structure, etc. resulting from the merger.

Governments will also be favourably inclined towards international foothold mergers since they bring into the local market a new competitive element. The entrant sometimes even dislocates the position of a dominant firm in such a market. Governments welcome foothold acquisitions especially in those markets where barriers to entry are particularly high, for instance in concentrated industries when entry is costly.[40]

Another positive aspect of an international merger results from the lower social costs it probably entails. When for example a certain region or a certain sector of industry is economically backward, that country may, if it wishes to call in assistance from foreign private companies, choose between two different policies. It can stimulate foreign direct investment in that region or sector in order to give an injection with all the anticipated advantages resulting from such an investment. In this case the existing domestic companies in that region or sector will probably disappear because they are unable to compete with the more efficient new foreign company. The other policy the government can follow is to stimulate mergers with foreign companies. Then the existing companies can survive and the social and economic costs will probably be lower than in the first case.[41] The rehabilitation by a merger of a failing company in order to restore its viability is certainly a positive aspect of a merger, even to such an extent that a

36 Studies 'The problem of the concentrations in the Common Market', *Series Competition No. 3* (European Communities, 1966), p. 8 (translation H W).

37 Council of Ministers, 'Second Programme for the economic medium-long term policy', *Official Gazette*, No. L 129 of 30 May 1969, Council 69/157, p. 200 (translation H W).

38 P Sanders, 'Studies on the Preliminary Project for a Statute for the European Company', *Series Competition No. 6* (Edition European Communities, 1967).

39 *Official Gazette*, Nr. C 39, of 22 March 1969, pp. 1 and 7.

40 Address of R W McLaren, Assistant Attorney General, in Los Angeles, 27 May 1969 (*CCH Trade Regulation Reporter 1969*, par. 50,244), explaining the US position. In his address, 'Looking ahead in anti-trust' delivered in Chicago on 8 October 1969 (*CCH Trade Regulation Reporter 1969*, par. 50, 258) he repeated the view that foothold acquisitions by the conglomerates in concentrated industries would be welcomed as pro-competitive.

41 Prof. Uri in *Le Monde* of 23 February 1965.

merger which the US Department of Justice would otherwise challenge will ordinarily not be challenged under such circumstances.[42]

A more psychological reason why international mergers are to be preferred to national mergers has already been indicated in the Second Programme for the economic medium-long term policy by the Council of Ministers of the EEC, quoted before. It implied that international mergers would not arouse nationalistic feelings so much as national mergers of the same size would do. These feelings could have economic consequences in that a government might feel bound to protect the economic interests of the corporation resulting from the national merger, and resort to measures designed to keep out foreign competitors.

IV.A 2 INTERNATIONAL ACTIVE MERGERS

The positive attitude of governments towards international active mergers is governed more by long-term than by short-term motives. They are similar to those for direct investments abroad. The Reddaway Report[43] shows quite conclusively for the UK that on an average direct investment *strengthens the future balance of payments on current* account out of the backflow of the returns from the [illegible] favourable impact on their balance of payments from mergers concluded abroad than from direct investments overseas. This is an advantage over direct investments since governments tend to attach greater value to earlier favourable effects on their balance of payments than to longer term ones.

IV.B Negative attitudes of national governments towards international mergers

IV.B.1 INTERNATIONAL PASSIVE MERGERS

The *reasons for a government's negative attitude* can be divided into economic and political ones. Broadly speaking they are closely akin to those that inspire the attitude of governments towards foreign direct investments within their borders.

With regard to the economic reasons, governments may be concerned about the future foreign currency commitments which will arise from the transfer of profits and capital repayments entailed by the merger, but in as far as they take a short term view of these commitments this will not worry them so much. In order to avoid disturbances on the local capital market, however, governments may require that capital outlay for domestic acquisitions by aliens should, wholly or partially, derive from external funds. This condition is imposed for instance by the governments of the UK[44] and the Netherlands[45].

A specific economic feature of international mergers as against foreign direct investment is that international passive mergers may give rise to anti-trust objections. Since anti-trust policy varies from country to country the positions taken by the different governments towards international mergers are not similar either. This is neatly illustrated by the difference in [illegible] Trade, said:

> ... there was much discussion ... as to whether we should establish precise guidelines on the American model ... such guidelines would in a British context be intolerably rigid and we ... stick to the pragmatic and empirical approach ...

In this connection, then, the government's anti-trust policies can only be dealt with in a rather broad and indicative way.

[illegible] out of an existing company. This decline in the number of local firms may affect the domestic market structure as well as the foreign trade of the country.

The impact on market structure, especially in concentrated industries, may sometimes result in a reduction of competition.[48] An international merger may provoke countervailing mergers, thus increasing the rate of concentration in the industry even more. In the case of a horizontal merger the reduced number of firms left may increase the possibility of collusive action or discourage price competition and encourage other kinds of conduct, such as excessive promotional expenditure which may lead to wastes of competition. In the case of a vertical merger the freedom of choice for the supplier (upstream merger) or for the customer (downstream merger) may be impaired. Vertical mergers may raise barriers to entry in an undesirable way and may be to the disadvantage of existing non-integrated firms.

Mergers may further lead to the creation or extension of dominant positions on the market, with the risk that market power may be abused. This aspect may also appear in the case of international mergers when the acquiring firm abroad is a particularly large one. By 'leverage' or 'deep-pocket' financing the acquiring firm could then subsidize the operations of the acquired domestic firm until its independent competitors have been substantially reduced in size

42 Merger guidelines announced by the US Department of Justice, Enforcement Policy for Sect. 7 Clayton Act, 30 May 1968, *CCH Trade Regulation Reports 1968*, Par. 4430, points No. 9 and 15.

43 W B Reddaway, *Effects of UK Direct Investment Overseas, Final Report* (Cambridge University Press, 1968), pp. 334 and 338.

44 By virtue of implementing Section 30(2) and (3) of the Exchange Control Act, 1947.

45 This requirement, in so far as applicable to nationals of the member States of the EEC, was recently challenged by the European Commission.

46 For the USA: Merger guidelines announced by the US Department of Justice, Enforcement Policy for Sect. 7 Clayton Act, of 30 May 1968 (*CCH Trade Regulation Reports No. 363*, 3 June 1968), 31 pages. For the UK: *Mergers, a guide to Board of Trade practice* (HMSO, 1969), 82 pp.

47 *Financial Times*, 1 August 1969.

48 S H Hymer, *Hearings on International Aspects of Anti-Trust before the Subcommittee on Anti-trust and Monopoly*, US Senate 20 April 1966, pp. 19–32.

or driven out of the market. This procedure need not actually be carried into effect. Competitors, anticipating what may happen, could be discouraged in advance from starting vigorous competition, in the hope of being left alive by the benevolence of the newly merged international firm.

In short, the reasoning holds that a change in market structure caused by the merger will provoke a change in market conduct, entailing a reduction in competition locally as well as abroad, which in turn is bound to impair market performance.

Apart from its effects on the domestic market itself the international merger may also have repercussions on the country's foreign trade. The acquired domestic firm may be restrained from exporting while the acquiring firm abroad may refrain from importing to that country when the acquired firm has its own manufacturing facilities at its disposal. A decline in competition through internationalization of an industry may thus—according to Hymer—reduce the natural variety of consumer goods stemming from several different traditions and reduce the rate of innovation or technological change.

In outlining the above possible consequences of international passive mergers it should be emphasized that every case should be examined on its own merits. Kindleberger[49] was right in stating at the US Senate's hearings that 'There is no simple rule of thumb that all direct investment[50] is bad or all direct investment is good. Direct investment sometimes increases competition and sometimes reduces it.'

Other objections to international passive mergers are of a more politico-psychological nature although with an economic connotation, and resemble those inspiring the negative attitude to direct investments, discussed earlier in this paper. The Canadian Task Force Report[51] expresses these objections in a clear and succinct way: 'Canadian ownership and control facilitates the exercise of Canadian economic policies. The major economic cost is the possible impediments to the creation of a more independent national economy.'

Apart from the fact that the policy of the newly created company will not always be in compliance with the policies of the nation state, the merger itself can create tensions in that its consequent elimination of unprofitable or overlapping capacities may run counter to the government's regional or employment policy. These difficulties can be alleviated if the government seeks certain assurances from the acquiring firm before allowing the merger to be consummated.

The feelings that a firm located abroad may not comply to public policy have even prompted governments known for their liberal attitude, like Belgium and Western Germany, to take direct or indirect steps to prevent take overs. Even in Switzerland and Austria take-over projects have been abandoned in response to adverse public opinion.[52]

Not only the anticipated lack of allegiance from abroad plays a role but also the fact that a take-over represents a change from the existing situation into uncertainty. As a result of foreign control established traditions may be abruptly altered and social environment shaken.[53] A proposed take-over by International Telephone and Telegraph Corp. NY of the Emaljeverket A/S in Norway provoked a strike of the latter's labour force, which exhorted the government to refuse the grant of a concession.[54] All this proves that the transfer of control to a foreign company provokes feelings of frustration that cannot be explained by economic reasons alone. These feelings are more marked in the case of an international take-over than when a direct foreign investment is involved, because in the former case the control of an already existing domestic company passes to a foreign company abroad.

As already discussed in connection with the international direct investment, the negative attitude of governments becomes even more strongly expressed when vital sectors and key sectors are involved such as technologically highly advanced industries.

IV.B.2 INTERNATIONAL ACTIVE MERGERS

The reasons for the negative attitude of governments towards international active mergers should be sought in the economic field only.

First of all the outflow of capital has of course an adverse short-term impact on the balance of payments, which may prompt governments to stipulate that capital outlay for acquisitions abroad should be wholly or partially raised on foreign capital markets, a condition which is imposed for instance by the governments of the US[55] and the UK[56]

Secondly there are again anti-trust aspects involved. Acquisitions abroad like international passive mergers, may harmfully affect competitive conditions on the domestic market as well as the foreign trade of the home country of the acquiring firm.

A firm may buy out a competitor abroad who owns production plants established in the home country of the acquiring firm. Thus the take-over abroad can lead to suppression of competition on the domestic market.

On the other hand the acquisition of a firm abroad may have a harmful effect on its exports to the country where the acquiring firm is located, while conversely the latter firm might restrict or abandon its exports to the country where the acquired firm is established. In so far as such restrictions of external trade are considered contrary to public policy the

49 Ch P Kindleberger, *Hearings on International Aspects of Anti-trust before the Subcommittee on Anti-trust and Monopoly*, US Senate, Part 1, 27 April 1966, pp. 152–3.
50 From the context it is clear that the term 'direct investment' is used by Kindleberger to denote merger operations as well.
51 Watkins Report, p. 389 and p. 40.
52 R Hellman, 'US Direct Investment in Europe—recent trends and reactions', Paper presented to the Conference of the Atlantic Council (May 1969, not yet published), p. 11.
53 R Hellman, ibid., p. 13.
54 The Norwegian government eventually vetoed the IT and T offer, saying that serious and attractive alternatives had emerged.
55 Executive Order No. 11,387 of 1 January 1968, Commerce Departmental Order 184-A (15 CFR Part 1,000) re. annual limits on capital outflows and reinvested earnings (*Federal Register*, Vol. 33, No. 1, pp. 17–54, 3 January 1968).
56 *Annual Report on Exchange Restrictions of the IMF* (1968), p. 450.

government will feel it necessary to take remedial action. As in cases of passive mergers, here also each case should be appraised on its own merits. No general opinion can be expressed in this respect.

[illegible]

In how far and in what way the negative attitudes of governments are actually translated into remedial action will be dealt with in the following two chapters, the first dealing with actions against international passive mergers and the second with those against international active mergers.

V GOVERNMENTAL ACTION TOWARDS THE INTERNATIONAL PASSIVE MERGER

The international passive merger, i e. the merger at home of a foreign corporation with a domestic com- [illegible] to such an operation.

Whenever it deems such an operation to be beneficial to the national interest it will attempt, by means of a host of measures and policies, to further the entry of international corporations Although it will generally prefer the foreign corporation to set up a joint venture *—a partial merger—with the domestic corporation* so that the latter can share the technical and commercial know-how, the managerial abilities and tech- [illegible] 'failing' one.

However, as explained before, certain conditions may arise which prompt the government to oppose the merger of a foreign corporation with a domestic *one as being contrary to the public interest. In doing* so the government may rely on statutory and regulatory powers conferred on it but, as practice has shown, sometimes it may rely on its persuasive powers [illegible]

V.A International passive mergers and anti-trust legislation

In some OECD States anti-trust legislation is totally lacking, as for example in Italy. In others, like France and the Netherlands, even if anti-trust legislation *exists, it does not contain special provisions governing* mergers.

In those legal systems where legislation on mergers does exist, it is often a lex specialis in respect of the general law on anti-trust. The tools developed by legal *systems to cope with the merger phenomenon* are prohibition or prior authorization or notification. Prohibition may take one of two forms: it may either prohibit, subject to certain conditions, the performance of those specific acts whereby the distinctiveness of enterprises can be ended, as in the United States, or alternatively it may state the general principle that, in certain conditions, enterprises will not be permitted to cease to be distinct, like the 1965 Act in the United Kingdom.[37]

Merger control legislation in the *USA* is governed partly by the Sherman Act of 1890 (amended in 1937), and partly by the Clayton Act (amended in 1950) which prohibits the acquisition by one corporation of the corporate stock or the assets of another corporation where the effect of such acquisition may be 'substantially to lessen competition or to tend to create a monopoly.' In addition the Federal Trade Commission has set up a warning system on large mergers in that any company with assets of more than $250 *million must now notify the FTC of its intention to* acquire any other company with assets of more than $10 million. Likewise any merger resulting in a corporate entity with assets of more than $250 million must be notified to the FTC.

In Canada Section 33 of the Combines Investigation Act, as amended in 1960, makes it an indictable offence for any person to be a party to or knowingly to assist in the formation or operation of a merger. Broad as this rule may appear, in fact the notion of *'merger' has a very restricted sense. The term is, by* legal interpretation laid down under Section 2(e) of the Act, limited to acquisition of shares or assets, or to control over the interest in another enterprise whereby competition is or is likely to be lessened contrary to the *interest of or to the detriment of the public*

Although the *European Economic Community* Treaty does not contain a special provision on mergers, the European Commission has elaborated an interpretation of Article 86 of the Treaty dealing with the prohibition of the misuse of dominant positions *that* amounts to a prohibition of mergers under certain circumstances. The Commission has proclaimed on various occasions[38] that it considers a misuse to exist, firstly where an enterprise taking advantage of its dominant position forces another enterprise to agree to a merger, and secondly where the merger of an enterprise holding a dominant position with another enterprise results in a monopoly on the Common Market or a substantial part thereof

In its three years programme of work dated 20 March, 1969 the Commission seems to extend this thesis, since it states there that a merger resulting in a restriction on effective competition would already be suspect vis-à-vis Article 86. In that programme the Commission also contemplates instituting compulsory [illegible]

[37] D G Goyder, 'Public Control of Mergers', *The Modern Law Review*, Vol. 28 (1965), p. 655.
[38] Mr v d Groeben, *Competition Policy as part of the Economic Policy in the Common Market*, Address to the European Parliament on 16 June 1965 (EEC Publication, June 1965) Abridged version in *Monthly EEC Bulletin*, 1965, No. 7, p. 14. Studies 'The problem of concentrations in the Common Market', *Series Compet* [illegible] (Brussels, 1966).

period in order to enable the Commission to express an opinion on the plans for these concentrations. Such practice would approach markedly the Coal and Steel Community's prior authorization procedure on mergers.

In the opinion of the Commission Article 85—the provision prohibiting cartels—is neither intended nor suitable to be applicable to merger operations as such. The views of the Commission have not yet been tested in court since no official proceedings on mergers have yet been instituted.

Merger control legislation also exists in the United Kingdom and, in theory, in Belgium. In the *United Kingdom* the Monopolies and Mergers Act 1965 governs this issue and provides broadly as follows. The Government may refer to the Monopolies Commission—which is not a Government instrument—proposals for mergers, take-overs or acquisitions of assets either where the value of the assets to be acquired exceeds £5 million, or where the transaction could result in a monopoly situation arising as defined and in the circumstances described in Section 6(1)(b)(i) of the Act. The Government has power under Section 6(11) of the Act to stay the proposed merger operation pending the report of the Commission, which has to address itself to the matters described in Section 6(2) of the Act, and must report within six months. If the Commission reports that the transaction can be expected to operate against the public interest the Government has power under Section 3 of the Act to make an order—which must be approved by Parliament—either prohibiting the transaction or modifying it or imposing conditions on the parties concerned. The Government is not, as a matter of law, obliged to follow the recommendations of the Commission, but in practice it would be extremely difficult, for political reasons, for the Government to act in a manner more drastic than that recommended by the Commission.

The Government has power to order the dissolution of any transaction which falls within the provisions of the 1965 Act and has already been implemented. For this reason, although the Act lays no obligation on the transacting parties (except in the case of newspaper mergers) to notify the Government or obtain its consent before implementation, the parties invariably do so in practice because a dissolution order could have disastrous consequences for the enterprises involved.

In *Belgium* the Act on the misuse of economic power provides that if a company, after having previously been convicted of a misuse, is held to be guilty of recidivism, such company may be prohibited, by Royal Writ, from effecting a merger with another named company (Article 15 of the Act).

Prior authorization for a concentration is needed in the *European Coal and Steel Community* (Article 66 ECSC Treaty). The authorization request must be submitted for decision to the High Authority, which laid down in Regulation No. 24/54 the types of acts and agreements which have the effect of a 'concentration'. The merger operation is one of them. Small merger operations are exempted from a prior request for authorization pursuant to Regulation No. 25/67. The High Authority is obliged under the Treaty to grant the authorization requested if it finds that the operation envisaged does not confer upon the enterprises involved any power (1) to determine prices, to control or restrict production or distribution or to prevent the maintenance of effective competition, and (2) to evade the rules of competition resulting from the Treaty's execution, in particular by establishing an artificially privileged position involving a substantial advantage in access to supplies or markets.

A notification ex post of a concentration operation to the Cartel Office is compulsory in *Germany* pursuant to Article 23 of the Act against Restraints of Competition (1957)—as amended in 1966[59]—in those cases where either (1) any one of the participating enterprises has already obtained or the combined participating enterprises obtain a share of 20 per cent or more of the market concerned or (2) the participating enterprises employed 10,000 or more persons, or had a turnover amounting to DM 500 million or more, or had total assets amounting to DM 1,000 million or more. The German Cartel Office is empowered under Article 24 of the Act to summon the enterprises involved to attend a hearing or to submit a written statement if there is reason to expect that the enterprises involved will obtain a dominant market position or if a dominant market position is strengthened by the merger. No further remedial action against mergers is provided for in the Act.

In December 1969, however, the Federal Ministry of Economic Affairs announced proposals for amendments to the Law against Restraints of Competition entailing a virtual control of mergers. They provide that notification of a merger—according to the same criteria as currently prevailing—can be made before or after the conclusion of a merger. In the latter case parties run the risk of a dissolution order.

After the notification the Bundeskartellamt starts investigating. Criteria for outlawing the merger are the acquisition or extension of a dominant position on the market or any other elimination of effective competition. Nevertheless the merger can be permitted for pressing reasons of public policy. If there is no objection the Bundeskartellamt grants a negative clearance declaration within three months after the prior merger notification. If it raises objections the issue is referred to the independent Monopolies Commission—which has yet to be created—for advice to the Ministry of Economic Affairs, which must take a decision within nine months after the date of the prior merger notification.

A simple registration of the newly created corporation to the Cartel Office is provided for in *Austria* by the Cartel Act of 1951—as amended in 1962—if the merger results in a corporate entity occupying a dominant position, the criteria of which are defined by percentages of market shares in the Act. This registration is passed on to the Cartel Court, which is obliged to make additional inquiries if specified public bodies so demand.

In *Spain* under the Act on Practices Restricting

59 These amendments were embodied in the Act of 15 September 1965 which entered into force on 1 January 1966. (*Bundesgesetzblatt I*, Nr. 53 of 22 September 1965, p. 1363.)

Competition[60] concentration operations have to be entered into a public register whenever such operations result in a control of 30 per cent or more of the market for a certain product or service (Article 21, par. 7). Concentration operations are understood to mean mergers, the purchase of the assets, management-contracts and the acquisition of 25 per cent or more in the capital stock of another enterprise.

In the *Netherlands* any form of merger of credit institutions among themselves or with other enterprises is prohibited unless permission from the Central Bank is obtained. (Act on the Control of the Credit-system, Article 13, par. 1, sub b, and c.)

In *Switzerland* under Article 22 of the Cartel Act powers to issue orders enjoining merging companies to fulfil certain specified requirements have been vested in the Federal Supreme Court acting on complaint lodged by the Federal Economic Department.

Up to now a sketchy and undoubtedly incomplete picture has been outlined of the legislation governing mergers in the OECD States. The issue that should now be analysed in the context of the international aspects of merger policy is whether the interpretation and implementation of the relevant laws result in a different solution for foreign companies being involved in a domestic merger vis-à-vis the position when the merger was undertaken by domestic companies alone.

Only those legislations which in themselves provide for an effective control on merger operations are relevant in this connection. Therefore only the United Kingdom's, the American, the Canadian and the Coal and Steel Community's regulations come up for closer examination.

V.A.1 UNITED KINGDOM'S ANTI-TRUST POLICY TOWARDS INTERNATIONAL PASSIVE MERGERS

The Monopolies Commission has hitherto directly addressed itself only once to the question of whether a transaction bringing a British company or British assets under foreign control could operate contrary to the public interest. In the Dental case[61] where such [illegible] Commission foreign control in itself would not operate against the public interest.

However, it is quite natural that the Government's steady preoccupation with its balance of payments troubles looms heavily on the Commission's considerations of whether a merger involving a foreign company is likely to operate against the public interest or not. In the Monopolies Commission's report on the BMC and Pressed Steel merger it was made quite clear that the merger's impact on exports was considered of paramount importance. The Commission held under Section 54:

> On balance, therefore we think that in this case there is seen appreciable advantage in Pressed Steel being taken over by a British rather than a foreign company because with Pressed Steel in foreign hands questions might also have arisen about remittances abroad and perhaps about 'rationalisation' of Pressed Steel's exports to fit in with a pattern which better suited the policy and the other interests of the foreign principal.[62]

The Commission also dealt with the question whether the export earnings of Pressed Steel's former customers, now possibly being cut off from their source of supply by this vertical merger, would be adversely affected.

Equally interesting is the holding of the Commission under Section 57:

> Had Pressed Steel been taken over eventually by someone other than BMC and more particularly by some foreign company, BMC might have been compelled to set up additional manufacturing capacity of its own, and thus might have involved a wasteful duplication of national resources.[63]

It appears from the Thorn–Radio Rental merger's investigation[64] that an overriding value is attached to the fact that British industry needs stability and security in its home market as a basis for establishing itself in overseas markets to meet its competitors over there on equal terms.

This holding could hardly apply to a foreign corporation establishing itself by way of a merger on British shores. The fact that Thorn had already a substantial share of the UK home market, and that this would be still larger if the merger took place, did not deter the Commission from giving more weight to the home market argument. Even though the Commission doubted whether the proposed merger was likely to have any decisive effect on the ability of Thorn to compete with foreign producers, it held that:

> Security of outlet in the home market might for the time being afford the manufacturer concerned some measure of protection against competition from imports, the proposed merger would not place any obstacle in the way of development of the export trade.

The Monopolies Commission's report on the Rank-De La Rue[65] merger-proposal reveals equally that, besides greater efficiency, the benefits to the balance of payments is now the Government's main criterion in evaluating mergers. The following conclusion under Section 103 may be quoted as typical

> But several of De La Rue's operations are in fields in which it is the leading company . . . with overseas competitors, so that any loss of efficiency would correspondingly harm the public interest including the balance of payments.[66] On these grounds the merger was prohibited although its adverse effects on competition were held to be negligible. Thus the state of competition in an industry was no longer considered as the leading criterion in applying the Monopolies Act.

It was understood that at a meeting on 13 June 1969 between Mr Crosland, then the President of the Board of Trade, and members of the Monopolies Commission general agreement was reached that

[60] Ley sobre prácticas restrictivas de la competencia of 20 July 1963, *Official Gazette* (Boletín Official del Estado) 1963, No. 175, p. 11,148.

[61] The Monopolies Commission, *The Dental Manufacturing Co. Ltd, or The Dentists' Supply Co. of New York and The Amalgamated Dental Co. Ltd. A report on the proposed mergers* (HMSO, 1966).

[62] The Monopolies Commission, *The British Motor Corporation Ltd and the Pressed Steel Company Ltd. A report on the merger* (HMSO, 1966), p. 16.

[63] Ibid., p. 1.

[64] The Monopolies Commission, *Thorn Electrical Industries Ltd and Radio Rentals Ltd* (HMSO, 1968), pp. 63 and 64.

[65] The Monopolies Commission, *The Rank Organisation Ltd and The De La Rue Company Ltd. A report on the proposed acquisition* (HMSO, 1969).

[66] Rank-De La Rue case, ibid., p. 29.

highest priority for testing mergers and take-over bids will be given to the potential gains in efficiency and the advantage to the balance of payments.[67] Bringing these guiding principles in relation to merger operations with foreign firms, Mr Crosland's statement in the House of Commons on 17 April 1969 can be quoted: '. . . particularly in the case of a take-over bid from overseas, I may need to be assured that exports will not be prejudiced nor imports unreasonably increased'.[68]

In practice the Government uses its discretionary power of reference to the Monopolies Commission under the Act to extract undertakings from companies contemplating transactions falling within the provisions of the Act. For example it was announced recently that the Government did not intend to refer to the Monopolies Commission a proposal whereby an American company would acquire control of a British confectionery company, following the receipt of suitable undertakings from the American company concerning the safeguarding of the export performance of the British company.

In its mergers' handbooklet the Board of Trade outlines broadly its policy on mergers as follows:[69]

The objective is to increase industrial efficiency and international competitiveness . . . The approach is empirical and pragmatic . . .

Where a UK company is involved in a merger with an overseas company the Board of Trade is interested in the likely consequences to the balance of payments. Questions arise as to whether there will be any restriction on the British firm preventing its competing in markets of the overseas company, whether there will be a transfer of manufacture out of the UK to the overseas company or its subsidiaries, whether the UK firm in future will be required to import from abroad what previously was bought in the UK or to alter its sources of imports, whether effective management of the UK firm will rest in the UK (with British nationals) and what the consequences are likely to be for the flow of technology and earnings from licensing. Quite a lot of searching questions indeed, which are mainly designed to ensure above all that the UK firm's foreign exchange earning capacity will not be impaired.

It can therefore be concluded that the Government would certainly endorse a merger with a foreign company if it will entail greater efficiency and a showing can be made or an assurance can be obtained that the exports of the 'emergent' company will not be impaired. Nevertheless, all other elements being equal, a merger with a domestic company would be preferred for its presumably greater benefits to the balance of payments and its firmer hold on the home market, thus avoiding excessive imports.

V.A.2 US ANTI-TRUST POLICY TOWARDS INTERNATIONAL PASSIVE MERGERS

When trying to ascertain US anti-trust policy towards international passive mergers one is liable to tread dangerous ground. For one thing it was not until 1967 that cases on mergers and acquisitions in the US in which a foreign corporation was involved were adjudicated under Section 7 of the Clayton Act. The first case to come up for trial concerned a joint venture between a US and a foreign company.[70] This was the Mobay case. Mobay was established in 1954 by Monsanto and Bayer. Early in 1964 complaints were filed that the joint venture was in violation of Section 7 of the Clayton Act, Monsanto having substantially terminated its production and sale in the US of a certain chemical manufactured by Mobay, and Bayer not having exported any substantial quantity of that chemical to US companies other than to Mobay which, by 1962, had acquired 50 per cent of the American market in that product. In January 1966 the Department of Justice informed the parties that it would agree to a settlement if either partner's interest in Mobay were sold to an acceptable purchaser (which could include the other partner). Since no other suitable purchaser could be found Monsanto decided to sell its interest in Mobay to Bayer, thus leaving Mobay as a wholly owned subsidiary of Bayer. Under a consent judgement entered in March 1967 the case was settled.[71]

The second case concerned Canadian Aluminium Ltd[72] which, through its US subsidiary Alcan, was required under the terms of a consent judgement to offer for sale within a period of nine months a portion of the assets acquired from National Distillers and Chemical Corp. In a subsequent judgement[73] the order of divestiture was rescinded since no eligible buyer came forward.

Third came the ARCO Sinclair case where the court originally issued a temporary restraining order[74] barring the merger. Later, however, it vacated this injunctive relief[75] on the ground that the postmerger sale of Sinclair properties to British Petroleum Oil Corporation eliminated the probability that the Government would succeed in showing a violation of Section 7 of the Clayton Act. Instead of competition being eliminated, BP as a new, vigorous and viable competitive force—so the court held—would replace one of the merging firms.

The complex deal between British Petroleum Co. Ltd and Standard Oil Co. of Ohio (Sohio) which was eventually to lead to a take-over by BP of Sohio, received much publicity in the second half of 1969. After the US Department of Justice announced that it would file an anti-trust suit against the proposed merger and emotions ran high, with accusations of protectionism and diplomatic representations being

67 *The Times* of 14 June 1969.
68 *Hansard* Report of Debates in the House of Commons for 17 April 1969, col. 1361.
69 *Mergers: a Guide to Board of Trade practice* (HMSO, 1969), p. 1.

70 B Bock, *Mergers and Markets*, The Conference Board Study No. 93 (1966), p. 217.
71 *US v. Monsanto Co., Farbenfabriken Bayer AG, and Mobay Chemical Co.*, CCH Trade Cases 1967, par. 72,001 (W. D. Pa. 1967).
72 *US v. Aluminium Ltd, Alcan Aluminium Corp. and National Distillers and Chemical Corp.* (DCNJ, 1966), CCH Trade Cases 1966, par. 71,895.
73 *US v. Aluminium Ltd, Alcan Aluminium Corp. and National Distillers and Chemical Corp.* (DCNJ, 1968), CCH Trade Cases 1968, par. 72,631.
74 *US v. Atlantic Richfield Co. and Sinclair Oil Corp.* (SDNY, 1969), CCH Trade Cases 1969, par. 72,715.
75 *US v. Atlantic Richfield Co. and Sinclair Oil Corp.* (SDNY, 1969), CCH Trade Cases 1969, par. 72,716 (297 F. Supp. 1060) and par. 72,728 (297 F. Supp. 1075).

, made by Her Majesty's Government to the US Secretary of State, the anti-climax came with a consent decree[76] entered into in November 1969. Under this decree the merger was permitted provided a substantial number of outlets were disposed of, partly to reduce the market share in the State of Ohio, partly to eliminate overlapping outlets in Western Pennsylvania.

It seems somewhat speculative to infer from these cases, which were all settled by consent order, the pattern of US anti-trust policy on international passive mergers. However, bearing in mind the whole US anti-trust philosophy and the outspoken opinion voiced in the ARCO Sinclair case, one may conclude hat US anti-trust policy welcomes the entry of foreign ompanies in itself since it introduces new competitive rces into the US domestic market. This assumption is ipported by the fact that the acquisitions by BASF iermany) of Wyandotte Chemical Corp. (Michigan) d by Koninklijke Zout-Organon (KZO, Netherlands) International Salt Comp. (Philadelphia) passed hout opposition, although after some initial frowns. 'he Aluminium case can hardly be indicative of olicy in this field since Aluminium Ltd had long well entrenched in the US market through its ly owned subsidiary Alcan, and consequently hallenged take-over did not entail a new com- ve element in the US market. The Mobay case t show a clear lead either, because of the mmittal proposals of the Department of Justice, for the fact that no discriminatory attitude foreign investors was adopted.

s not so surprising that the Department of Justice tion in the BP–Sohio merger case since BP Ltd oot on the US market through its acquisition nclair assets three months before, and thus the d take-over did not constitute a wholly new ve element in the US market. Obviously the nt of Justice applied the potential com- octrine,[77] holding that prior to the merger , BP was a likely new entrant into the Ohio rting considerable influence by virtue of at the market's edge, and that its entry by nerger entailed the elimination of a and significant potential competitor, ame time the substitution of Sohio by ket would raise the threshold to new

n stating that BP was accorded no more urable treatment than would be given ompany in BP's position the Depart- clearly overlooked the difference in a European corporation which had re than a toehold in the American nths before, and the well entrenched ny American firm in BP's position in industry would command. There was bability that BP would have entered market but for a merger, as it had

to generate all its available financial and managerial resources in the US to get the recently acquired Sinclair outfit into a profitable operational condition.

It does not in any case seem warranted to put on a par an American firm and a European corporation which has not yet acquired a well entrenched position in the American market, when their respective efforts to obtain a foothold in some geographical area of the American market by way of a merger are evaluated. As it is, the US market constitutes an insuperable hurdle for European corporations when they want to enter it alone. The principal reasons for those entry barriers[78] are the following:

Entry requires a substantial amount of capital since the market is large, diverse and unknown. Because wages are high, extensive investments in great depth are indispensable. Thus entry into the US market requires more resources than European corporations can command or are willing to commit to a single market.

There is a lack of a sufficient fund of good managerial talent that can be sent to the US.

Because the US market is very sophisticated and US competitors are very strong in every respect on their own market, it is essential for a European corporation to have a US partner with experience of the necessary skill and techniques to operate there.

Because of these natural economic entry barriers the only alternative for a European firm is to enter a joint venture with a US enterprise. It would, therefore, imply an undue legalistic approach if the capacity of a European corporation as a potential competitor and probable entrant in some part of the American market were to be assessed along the same lines as an American enterprise, and if the existence of the natural barriers to entry were to be neglected.

Justified as it may seem from an American point of view, the existence of the US anti-trust laws and the way they are applied to mergers constitute undeniably a deterrent to the entry of international corporations from overseas in the US market, having regard to the considerable difficulties confronting them if they were to penetrate on their own by direct investments. It is an ironical fact that the laws designed to preserve competition are in themselves instrumental in preventing the emergence of new competition.

Certain operations such as airlines, communications (telephones) or other so-called regulated industries[79] may by their nature come under special regulations if and when foreign interests become involved.

V A.3 CANADIAN ANTI-TRUST POLICY TOWARDS INTERNATIONAL PASSIVE MERGERS

Prior to 1960, Section 2(a) of the Combines Investigation Act defined a 'combine' as including a merger. In 1960 a separate definition for 'merger' was laid down in Section 2(e). There have been four cases in which the Crown has alleged that a merger offence under the Act had taken place. All these cases involved mergers among Canadian companies only. . ' OCF

l Co. (Ohio) et al. (US Ohio 1969), CCH 72,988, CCH Trade Regulation Reporter No. 2076.
ble Co., US Sup. Ct. 1967, 386 US 568. 87 e Cases 1967, par. 72,061

[78] Cf. J N Behrman, op. cit., pp. 58 ff.
[79] These special provisions for regulated industri in the Report on the 51 ILA Conference (Tok)

has the Crown been successful. The court's decisions in the two more recent cases[80] are of such a nature as to discourage any further litigation by the Department of Justice in this field. Their effect on the merger provision may have been to weaken it beyond judicial repair.[81]

In the Breweries case the court held that, in regulating the industry, the Liquor Control Board must be presumed to see that the interest of the public is protected in respect of matters ordinarily governed by free competition. In the Sugar case the judge stated that the Crown had not satisfied him beyond a reasonable doubt, that the merger in question destroyed or even limited competition. In each case the trial judge clearly adopted the view that to be unlawful the merger must result in a virtual extinction of competition.

In view of the severe tests which the judiciary is applying for proof of public detriment—apparently because Section 33 of the Act is a provision of a penal character—one may safely assume that the Act does not provide a legal basis for instituting an anti-trust policy directed against mergers where foreign—in particular US—companies are involved. Moreover there is a general consensus of opinion that effects of mergers resulting in changes in the degree of foreign control of Canadian industries fall outside the ambit of competition policy.[82]

V.A.4 EUROPEAN COAL AND STEEL COMMUNITY'S ANTI-TRUST POLICY TOWARDS INTERNATIONAL PASSIVE MERGERS

The economy of the ECSC sectors is an 'économie orientée', as is reflected in the basic Articles 3 and 5 of the ECSC Treaty. The High Authority made responsible for defining the general economic objectives for the coal and steel sectors has to take the appropriate measures to reach those objectives. The programmes for the implementation of the 'économie orientée' called—where necessary—for a direct intervention in the structure of the coal and steel industries. The High Authority was given the tools and powers to guide such development in these sectors equally where only national activities were involved, while the nation states had to abandon their control in this domain. In doing so the High Authority was obliged under the Treaty to avoid and prevent the creation of a situation where the normal play of competition, required by the Treaty, would cease to exist. The main line of policy laid down in the Treaty was to see that the merging of the national markets into a Common Market together with the measures of stimulation taken by the High Authority would bring about the structural development of the ECSC industries which were deemed to be required for the fulfilment of the principal aim of the ECSC, namely to serve the national economies of the member States.

The elaboration of this concept has, moreover, been influenced and even determined by certain facts, which, under the premises prevailing in 1952, the year the Treaty entered into force, called for certain rules on the control of concentrations. In the first place the fact that the Common Market was created for coal and steel alone, which privileged position might eventually have made them so strong vis-à-vis the other industries—generally their customers—that, instead of serving the general economy of the six member States, they would have dominated and distorted that economy, thus defeated the very purpose of the Coal and Steel Community.[83] This consideration in itself called for a certain measure of control on operations that involved the creation or extension of dominant positions in the coal and steel sectors.

In the second place under the situation existing in 1952, and according to the forecasts which were at that time accepted, coal as well as steel would be in short supply in the coming decades, so that monopolization of both sectors was deemed to be a real possibility. This position gave rise to the strong emphasis laid on the protection of the consumer's interests in Articles 3a, b and c, Articles 4d and 59, as well as the strict provisions of Articles 65 and 66 of the Treaty. At that time nobody had anticipated the findings of huge deposits of natural gas in continental Europe, nor the possibility of fierce competition in steel through imports from third countries because of changes in technology.[84]

Another reason for instituting international control in the coal and steel industries in 1952, even on purely national industrial activities, was the desire inspired by past experience to prevent the German heavy industries from exerting their political influence on the public affairs of the nation state.

Finally the influence of the American anti-trust experts and the deconcentration legislation of the Allied occupation authorities in Germany on the drafting of the Treaty should not be underestimated.[85]

The rationale of merger control in the ECSC at that time was therefore designed to internationalize the supervision in the coal and steel sector in order to prevent mischiefs in the political plane and to create a balance of economic power vis-à-vis the other economic sectors. These considerations of 1952 may not prevail any more, even though the need for the executive body—now the European Commission—to maintain, protect, develop and stimulate the 'économie orientée' in the coal and steel sectors persists.

(a) *Intra-community mergers*

In an integrated Common Market a differentiated evaluation of purely national mergers in comparison

80 *R. v. Canadian Breweries Ltd (1960), C. R. 601, R. v. British Columbia Sugar Refining Co. Ltd and BC Sugar Refinery Ltd (1962)*, 38 CPR 177.
81 R Gosse, *The Law on Competition in Canada* (The Carswell Company Ltd, Toronto, 1962), pp. 179, 204.
82 *Interim Report on Competition Policy of the Economic Council of Canada* (Queen's Printer, Ottawa, 1969), p. 82. A dissenting view was expressed by Prof. M Watkins, who criticized this report (*The Globe and Mail*, 4 September 1969).

83 These fears were already expressed by the Report of the French Delegation to the ECSC negotiations (1951) and in the *Avis et Rapports* of the French Conseil Economique (1951).
84 See Introduction to the *Wagenführ Report* (1963).
85 Address of J Linthorst Homan, member of the High Authority to the European Parliament, June 1965, *ECSC-Bulletin*, 1965, No. 57, p. 6.

with intra-community mergers is no longer of any relevance since the economic objectives of the Common Market as a whole are the touchstone for the appreciation of business conduct, and not the objectives of the various nation states taken separately. The early policy of the High Authority on concentrations seems to confirm this general statement. Of some 160 authorizations the High Authority granted up to 1 January 1968, ten were of an intra-community character. Since the decisions under Article 66 are not published, the considerations that led the High Authority to its decisions can be inferred only from its Annual Reports or other official ECSC documents. There was no indication to assume that the High Authority had adopted a difference in policy between both kinds of concentrations. Answering parliamentary questions the High Authority[86] confirmed that in principle there was no difference in policy between the evaluation of purely national and of intra-community concentrations.

In the last few years, however, the picture of the coal and steel market has changed. Coal redundancy has become widespread and in the steel market fierce competition has set in. Partly owing to these conditions there was resurgence of nationalistic sentiments, and the High Authority was confronted with serious symptoms of the disintegration of the coal and steel market, such as national subsidies to failing industries.[87] In this situation the High Authority has come to recognize the useful effects of intra-community concentrations on the integration process. This attitude appears from its appraisal in its Annual Report for 1967[88] of the proposed Dutch–German concentration between Hoogovens and Hoesch.

The useful role of concentrations across the borders in checking nationalistic feelings in the ECSC was also recognized by Raymond Prieur.[89] However, the issue of the appraisal of a national as against an intra-community merger has never come before the European Court.

(b) *Mergers with firms abroad*

Pursuant to Article 66 ECSC the High Authority has power to decide on direct or indirect concentration operations within the territory of the Common Market for coal and steel. This implies that a concentration between an ECSC firm and a firm located abroad does not come under Article 66, unless the latter already controls a firm within the ECSC. On the other hand a concentration between two firms both located outside the ECSC comes under Article 66, if both have subsidiaries within the ECSC.[90] For that reason Regulation Nr. 26/54,[91] based on Article 66, Section 4, lays down that non-ECSC enterprises—equally those located outside the ECSC territory—should notify the High Authority if they acquire more than 10 per cent of the equity of an ECSC enterprise.

Neither among the 160 concentration-authoriza- [illegible]

[illegible]

[illegible]

new development, in that enterprises from third countries, especially the United States, were acquiring participations in ECSC firms, entailing the possibility of indirect concentrations between enterprises within the ECSC. This development will be closely watched by the High Authority since it may exceed the limits set by Article 66.

The non-discrimination principle embodied in Article 4, Section b, would entail that no different policy should be adopted towards a merger in which a foreign-based firm is involved. It has, however, never been tested either by the High Authority or by the European Court, how this non-discrimination principle should be interpreted in this connection.

V.B Other statutory or regulatory powers on the control of international passive mergers

Irrespective of whether the government can control mergers under its anti-trust law or not, it will in general have some power, based on other legal provisions, to have a say in incipient merger operations. This power to control merger operations, in which a foreign corporation gets hold of a domestic enterprise, can be based on two different categories of legal provisions.

In the first place are those legal measures which are explicitly directed towards domestic mergers in which foreign or foreign-controlled companies are involved, and in the second place are those legal provisions which are applicable to any domestic merger operation, irrespective of whether only nationals are involved or whether foreign companies are equally associated in such operation. The discretionary power left to the governments in implementing the laws of this last category provides them with the opportunity to deal with the issues on a case-by-case basis, thus taking into consideration the relevant factors of each case. The fact that a foreign company is involved might be such a relevant factor.

Legal provisions in the first category are of four different kinds. First are foreign exchange control laws or regulations. Practically all OECD countries possess these foreign exchange and capital transfer laws and regulations in some form or another. Often the permission of the central bank or the Ministry of Finance or Commerce is required for the foreign corporation to acquire or to merge with a local company.

The reason why governments or their agencies want to have some supervision on the inflow of capital is the monetary one that such a merger transaction may give rise to repayments for capital repatriation and the payment of profits and royalties in the future, all entailing an adverse effect on the balance of payments. But because in the short run these capital transactions

[86] *EEC Official Gazette*, 1960, pp. 1078/79.
[87] It is debatable whether these measures are not contrary to the Articles 4, Section c and 67 ECSC.
[88] *15th General Report on the activities of the ECSC*, 1967, pp. 197/198.
[89] R Prieur, *La Communauté Européenne du Charbon et de l'Acier*, 1962, pp. 321/322.
[90] R Krawielicki, *Das Monopolverbot im Schuman-Plan*, 1952, pp. 63/4. P Reuter, *La Communauté Européenne du Charbon et de l'Acier*, 1953, p. 217. R Prieur, op. cit., 1962, pp. 305/6.
[91] *ECSC Official Gazette* of 11 May 1954, No. 9.

[92] ECSC Bulletin, [illegible]

result in a favourable effect on the nation's balance of payments these regulations are mostly implemented in a very liberal and lenient way.

These operations are, therefore, as a rule subject to routine approvals. It is, however, possible that in the course of such routine procedures the government may try to interfere in the proposed mergers and acquisitions, thus delaying or raising difficulties and exacting certain conditions with regard to operations that are in principle free from such restraints. When the central bank—a purely monetary agency—is to grant the permission it will usually have to attune its decision to the wishes of the government, which thus can force through a negative attitude or can exact conditions which in themselves are not necessarily prompted by monetary motives alone.

Secondly, of a broader scope than foreign exchange control laws, is legislation designed to control financial relations with foreign countries in order to uphold the national public interest. This type of legislation has been introduced for instance in France by Act No. 66-1008 of 28 December 1966,[93] which empowers the administration to institute such controls. Pursuant to this Act the administration issued Decree No. 67–78 of 27 January 1967[94] which actually instituted rules governing the notification of direct foreign investments—through stock acquisitions or acquisitions of assets—and subjected such investments to a prior authorization, even if there is no actual transfer of funds from abroad. This Decree applies to any foreign investment that amounts to 20 per cent or more of a company's capital.

Under this legislation France has effectively barred a number of American efforts to penetrate into those sectors of the French national economy which the government considers it a 'national imperative' to maintain in French hands, particularly the automobile, heavy electrical and electronic industries. Thus Westinghouse's bid to acquire a controlling interest in Jeumont-Schneider was prevented, and so too were the proposed participation by Leasco Data Processing Equipment Corp. in SEMA-Metra International and the setting up of a joint venture by Auerbach Corp.—a company dealing in computer software and through a joint venture associated with Honeywell Inc.—with CEGOS (Commission Générale d'Organisation Scientifique). The take-over by Chrysler of Simca and the take-over by General Electric of Bull were obviously instrumental in having this legislation passed.

Meanwhile the legality of Decree Nr. 67–78 has been challenged by the European Commission, in so far as this Decree applies also to direct investments made by companies based in one of the Common Market States. This is contrary to the Rome Treaty provisions concerning the free movement of capital and the right of establishment[95]. The French government argues that the legislation in question does not violate the Rome Treaty since it will not oppose foreign investments from 'real' European companies. According to the French government, European-based subsidiaries of parents established in third countries outside the Common Market are not protected by the Treaty (particularly Article 58 EEC Treaty). The French government maintains that such treatment is necessary, since it will not grant the same facilities to companies based in the Common Market but controlled by nationals of third countries, thus allowing a 'back door' penetration by American companies through European-based subsidiaries. The European Commission has now decided to take the French government to the European Court of Justice for violation of the Rome Treaty.[96]

In November 1969 the Belgian government placed a bill on Economic Expansion before Parliament. This bill subjects to prior authorization all foreign participations of 30 per cent and more in a company's capital.

The third kind of laws under this heading are concession laws, which are generally designed to prevent foreign invasion in certain sectors of the national economy.[97] For instance the Norwegian Act of 14 December 1917 lays down that corporations of foreign nationality must obtain a concession from the Norwegian government to own real estate and to carry on industrial activities. A joint-stock company is considered to be a 'foreign company' if a foreigner is a member of the board of directors or if more than 20 per cent of the share capital is owned, directly or indirectly, by foreigners. This means that any foreign company that wishes to start operations in Norway or to take over more than 20 per cent of the shares in a domestic enterprise must apply to the government for a concession. This is far from being a matter of form. If a Norwegian company declares itself willing to take over the shares at the same price it is not improbable that the concession will be refused. Where a concession is granted, it is customary to exact certain conditions, for instance in respect of the composition of the Board the majority of whose members—including the chairman—should preferably be nationals.

In Sweden the Law of 30 May 1916, as supplemented by the Law of 9 June 1967, stipulates that the acquisition of more than 20 per cent of the Swedish company's total capital by a foreign corporation is subject to government permission if the Swedish company is engaged in mining operations or if it wants to acquire real estate.

In 1964 several Canadian acts were amended to retain Canadian ownership and control of federally incorporated insurance, trust and loan companies,

93 Loi No. 66–1008 of 28 December 1966 'relative aux relations financières avec l'étranger' (*Official Gazette* of 29 December 1966).
94 This Decree has been supplemented by Decree No. 68–1021 of 24 November 1968 instituting foreign exchange control, and also by Decree No. 69-264 of 21 March 1969 (*Official Gazette*, No. 69-33 of March 1969, p. 27), which makes the provisions equally applicable to French direct investments abroad. A government order of 27 January 1967, supplemented by order of 24 November 1968 and also by order of 21 March 1969, clarifies the Decrees No. 67–78, No. 68-1021 and No. 69-264. The government order of 21 March 1969 in its turn has been clarified by a circular letter of 21 March 1969 (*Official Gazette*, March 1969, No. 69-33, pp. 31 ff.).

95 Cf. Articles 52–8 EEC Treaty, General Programme EEC Council, 18 December 1961 (*Official Gazette*, pp. 36/62 of 15 January 1962) supplemented by Article 221 EEC Treaty.
96 *European Commission v. French Government*, case 66–69, *Official Gazette*, No. C 156/12 of 8 December 1969.
97 For more examples pertaining to transportation and mining, *see* W H Balekjian, *Legal Aspects of Foreign Investment in the EEC* (Manchester University Press, 1967), pp. 31–41.

limiting the proportion of shares which might be held by non-residents to 25 per cent. The Bank Act revision of 1964 (introduced in 1965) extended to banks the same limitations previously applied to the other financial institutions.[98]

The laws of the fourth kind are designed for the protection of foreign investments. The guarantee for repatriation of capital, the transfer of dividends or royalties from the country concerned may be made conditional by such laws on prior approval of the initial investment or the merger.

In Greece the Law 2687/1953 on Investment and [illegible]

In Turkey the Foreign Investment Encouragement Law (Law No. 6224 of 18 January 1954) operates in an analogous way. No permission for the transfer abroad of profits or capital repayments will be granted [illegible] offer to exchange or sell national public funds to foreign or foreign-controlled companies shall be subject to prior authorization from the Minister of Finance. Such a provision is embodied in Article 108, Section 2 of the Belgian Commercial Code (Order in Council of 10 November 1967, Article 13).

Company Law, as in Denmark, Sweden, Finland and Switzerland, may stipulate that management must consist wholly or for the major part of national citizens. Exceptions may be granted by the government.

The second category of legal provisions on merger control contains those affecting any merger, irrespective of whether only nationals are involved or foreign companies equally take part in the operation.

1 Under this heading come the takeover bid laws like the Belgian Act of 10 June 1964 relating to the public acquisition of savings capital, amended and extended until 31 December 1972 by the Order in Council of 10 November 1967. Every public purchase or sale of shares is subject to prior examination of the 'Commission Bancaire' (Banking Commission) which may stop the operation involved for three months and may propose to the Minister of Finance to prohibit the whole operation indefinitely. Similarly the Province of Ontario (Canada) enacted a law to regulate takeover bids as Part IX of the Ontario Securities Act (1966).

2 The second group constitutes legal provisions aimed at a structural improvement of the national economy and entail tax concessions designed to facilitate merger operations. To this group belong the Austrian 'Strukturverbesserungsgesetz' of 23 January 1969 and the Spanish Tax Reform Acts of 1957 and 1964,[100] as well as the ensuing Executive Decrees of 3 October 1966 and 26 July 1967. This group also includes the Italian Fiscal Law Nr. 170 [illegible] registration tax (of 1923) may be reduced to a minimal fixed amount subject to government approval. Lacking such approval the above operations are still permissible, but they are not granted the indispensable tax facilities which make the mergers and acquisitions actually feasible. The government is therefore in a position to severely condition or limit mergers and acquisitions both national and international.

The enumeration given above does not claim to be exhaustive. The purpose was only to set out what kinds of legal provisions exist enabling the governments to control merger operations irrespective of whether domestic anti-trust provisions on the control of mergers exist or not. The various laws and regulations mentioned make it clear that governments are vested with a good deal of discretionary power for granting or refusing approval to the merger operation.

It is submitted that, certainly where there are no domestic anti-trust laws permitting effective control of mergers, anti-trust considerations are often not lacking when decisions are taken by the competent authorities on the merger operations This is sometimes apparent in the texts of the relevant legal provisions themselves.

For instance the Turkish Foreign Investment Encouragement Law lays down in Article 1 that

> This law shall apply to the foreign capital imported into Turkey . . . by . . . the approval of the Council of Ministers provided that the enterprise in which the investment shall be made
>
> (c) will entail no monopoly or a special privilege.

The Italian laws for tax facilities on mergers and acquisitions of 1965 and 1968 also provide explicitly *that the benefit of the government approval should be* made conditional upon observance of the rules of competition At the time when the fiscal law of 1965 was enacted the government had pledged that a law on competition was soon to be issued, which in fact has not been done. It is understood that the government agency in charge of reviewing the applications for the benefit will rely on the rules of competition of the EEC, and on general principles of freedom of competition, with the result that the government's discretion in this field is very wide.

In Spain the tax-concessions granted under the Tax Reform Acts of 1957[101] to facilitate mergers are [illegible] that no monopolistic activity is to be set up.[102] In

[98] Watkins Report, pp. 387-8.

[99] This Law was supplemented by Law No. 4171/1962 on the Measures to Stimulate the Development of the Country's Economy. The latter is applicable to both foreign and Greek capital employed in productive investment, and provides for a number of tax and other incentives.

[100] *Ley de Reforma del Sistema Tributario* of 11 June 1964 (*Official Gazette* of 14 June 1964). [illegible]

[101] This law, dated 26 December 1957, was published as a chapter of the 'Ley General de Presupuestos del Estado' [illegible] of 'Modificaciones en el sistema fiscal'. This law [illegible] always referred to as the 'Ley de Reforma Tr[illegible]

[102] This requirement is contained in the Tax [illegible] 26 December 1957 Article 1??), the Law [illegible]

Spain monopolistic activity is regarded as a misuse that can arise out of conduct of an enterprise having a dominant position on the market.

Thus in three instances a clear reference to rules of competition emerges from the statutes and regulations themselves when the government has to consider whether it should or should not grant a tax rebate that is indispensable to the whole merger operation, effectively deciding whether the merger will be finalized or not. It is a fair guess that equally in those cases which are governed by laws where no explicit reference is made to the rules of competition considerations of this nature will often partly determine the decision taken by the competent authorities.

The consideration that the penetration of a foreign company into a national economy could stir up market conditions and create a new competitive situation which—depending upon the actual state of the economy—may be either beneficial or detrimental, can hardly be far from the mind of an authority responsible for determining whether the merger operation is to go through or not. For that reason it is submitted that it is not only the anti-trust laws that profess to implement the rules of competition to a merger operation. In this respect it does not matter so much what title the relevant applicable legal instrument bears for competition principles to be applied.

Conversely, as we have seen, the UK Monopolies and Mergers Act puts an overriding emphasis on the monetary effects of a merger operation, a consideration more likely to be expected from a foreign exchange control law.

V.C Discretionary control on international passive mergers

Governments derive their discretionary powers of merger control either from legislative instruments conferring a broad delegation of power to the executive branch, e.g. where the carrying out of a multiple year plan is concerned, or from no legislative instrument at all. In the latter case merger control constitutes part of the government's political and economic policy to steer, guide and if necessary restructure the national economy in a way they deem fitting to the public interest.

For the implementation of the economic policies which the governments have adopted as their guiding principles, they need a certain measure of discretionary power. It depends on the political attitude of the governments whether they want to use this power of interference in full measure or whether they will prefer to limit their interventionist capability to some commanding heights in the national economy. Anyway since full employment and cyclical economic policy are among the major objectives of every national economic policy there is not a single government left that will abstain from any interventionism at all. It has now become more a matter of shades and degrees what kind of interference is still considered as politically admissible and what is not. Thus in so far as government conduct complies with the rule of law and is subject to parliamentary control it does not stray beyond the permissible range set for the proper exercise of governmental power. Under these conditions the government can implement and if necessary enforce compliance with its economic policy.

In this way one might contend that the 'visible hand' of the government is omnipresent. It may lend a helping hand for mergers to be carried through but it also may have an effective hand in preventing some merger that is on the verge of being concluded with a foreign firm. The ways and means of persuasion or dissuasion are manifold and varied in nature. Dependence upon government benevolence can in certain circumstances be decisive for a company because of the vital importance of government orders or purchases, or R and D contracts. A national company may hear that loans it has obtained will be withdrawn if it should merge with a foreign firm. Mergers between domestic enterprises are promoted through the grant of loans, the promise of substantial government orders or by governments acquiring an equity interest in the enterprises concerned by operations on the Stock Exchange, so that some of the participants in the merger will escape a takeover bid of a foreign corporation. Even the power of the nod, the wink and the quick call on the telephone may be sufficient.[103]

Sometimes a foreign corporation's proposal for merger may meet with a downright refusal from the government, like the original Fiat proposals in the Citroen–Fiat case, where the attitude of the French government turned out to be lacking any legal basis because the Decree No. 67-78 of 27 January[104] instituting governmental control on the acquisition of very important foreign participations (more than 20 per cent) in a domestic company, could not be implemented against national companies from other EEC countries according to the EEC Treaty provisions.[105]

When the Gelsenkirchen Bergwerks AG, the German coal-based company which has developed major petroleum interests in recent years was threatened to be taken over by the Compagnie Française des Pétroles which in its turn was controlled by the French government, the German government, without having any legal basis for its action, intervened energetically. As a result the Dresdner Bank refused to sell its 30 per cent interest to CFP, declaring that it was acting out of loyalty towards the German government.

These economic policies on mergers are generally implemented by the competent governmental ministries themselves. But sometimes government-sponsored or instituted agencies are engaged as holding companies or business brokers in rationalizing and restructuring national branches of industry, thus arriving at national solutions for the problems involved and keeping foreign penetration out. Suffice

1960 (Normes 6 and 7), the Tax Reform Act of 11 June 1964 (Article 107), the Decree of 27 July 1964 and the Executive Order of 5 April 1965 (Article 1).

103 *The Economist*, 2 August 1969, p. 58.

104 This Decree is based on the Act No. 66-1008 of 28 December 1966 which authorizes the government to put foreign direct investments under control in order to ensure the defence of the national public interest.

105 Answer of the European Commission to question No. 215/68 of M Apel, *Official Gazette*, No. C 6/3 of 22 January 1969.

it to mention here the British Industrial Reorganisation Corporation (IRC) which was, for instance, instrumental in thwarting the Swedish SKF plans to merge with a UK company in the ball-bearing field, and the Canadian Industrial Development Bank, which obtained government support to reduce the need for small Canadian business enterprises to sell out to foreign firms.[106]

Where foreign penetration is allowed government authorities often exact certain concessions such as:

(a) maintenance or expansion of a certain volume of domestic production,
(b) admission of domestic capital in the venture,
(c) maintenance of the identity of the acquired company and/or maintenance of nationals on the Board,
(d) optimal maintenance of employment for workers and staff,
(e) maintenance of export output,
(f) creation or maintenance of national research capacity,
(g) transfer of foreign exchange as payment for the acquisition,
(h) acceptance of participation by the state or its agencies.

The government intervention is inspired by various reasons. Often it wants to keep its vital sectors free from foreign domination since it feels that certain branches of industry constitute commanding heights in the national economy or national society because of their pervasiveness and their potential as bases for influence and control. This applies to financial institutions and all kinds of media of communication, both lying at the heart of the technostructure of modern society.

In other cases the government considers some key

[illegible]

necessary to keep some national branches of industry relatively independent for their being engaged in the domain of advanced technology, such as in the computer or nuclear field.

All these policies are mainly inspired by strategic considerations and by the fear of becoming dependent upon foreign resources and influences in fields where the government wants to maintain its own — economic, technological, cultural and political — sovereignty intact.

One may wonder whether anti-trust policy considerations enter equally into this domain. Where in a particular case some economic elements are deemed relevant, the relative dominant economic power of the foreign company in question may play a certain role in the government's decision, but where purely political considerations prevail the fact of being of foreign origin will already be sufficient to bar a foreign firm from acquiring a domestic company, and consequently anti-trust policy does not play a role at all.

[106] Watkins Report, p. 386.

VI GOVERNMENTAL ACTION TOWARDS THE INTERNATIONAL ACTIVE MERGER

The international active merger, i.e. the merger of a domestic company with a foreign company abroad, undoubtedly affects governmental policy in various ways. First of all such a merger implies an outflow of capital and consequently entails a loss of foreign exchange to the detriment of the balance of payments. The governments therefore wish to control and supervise these operations so as to have a check on such capital outflows. On the basis of national foreign exchange control laws these operations will therefore be subject to government approval, which generally will be determined by monetary considerations only. When a country suffers from a serious structural balance of payments deficit this approval will generally be hard to obtain.

In 1965 the United States instituted a Voluntary Balance of Payments Program under which American enterprises voluntarily limited the use of funds from the United States for foreign direct investments. On 1 January 1968 the US introduced mandatory controls over private investments abroad — the so-called Foreign Direct Investment Program[107] — aiming at reducing the US balance of payments deficit. This Program imposed limits on transfers of capital abroad and required repatriation of specified percentages of annual earnings of US affiliates abroad. The Program practically prevented US corporations from using American funds for effecting direct investments abroad or for acquiring a foreign-based company. The US corporation therefore had to depend on raising funds abroad to finance its foreign merger operations. This explains why American companies have been so active on the European capital market these last few years.

Where the Foreign Direct Investment Program requires repatriation of annual earnings of US affiliates abroad it imposes obligations on the conduct of American wholly or partially controlled companies

[illegible]

the international firm to the obligation that its subsidiaries abroad should equally abstain from trading with enemy countries defined as such by the home country, irrespective of whether the countries where the subsidiaries are located take the same view of such export trade or not.

Last but not least the extra-territorial application of anti-trust law should be mentioned. Of this subject a more extensive analysis will be made.

[107] Executive Order 11387 of the President. This Order is implemented by *Foreign Direct Investment Regulations* issued by the Secretary of Commerce.

[108] Hellman, 'Auslandsinvestitionen und europäische Souveränität', *Europa-Archiv*, 1968, pp. 679 ff.

[109] See in this respect the article on 'Extraterritorial application of the Securities Exchange Act of 1934' in *Col. Law Rev.*, Vol. 69, Jan. 1969, No. 1, pp. 94-111.

E Rehbinder, 'Neuere Entscheidungen z- [illegible] Anwendung des Securities Exchange [illegible] *schaftsdienst des Betriebs-Beraters*, [illegible]

VI.A The issue of the extra-territorial application of anti-trust law

The issue of the extra-territorial application of anti-trust law has been raised especially in connection with German, Austrian and US anti-trust law.

The German Act against Restraints of Competition states explicitly that it covers all restraints of competition, irrespective of their origin, that have an effect within its ambit, since its Article 98 Section II holds the Act applicable to 'all restraints of competition which produce an effect within the territory for which this Act is operative even if these acts were initiated from outside this territory'.

It is clear from this text—as is confirmed by the unanimity of the authors[110]—that the scope of the German Act is determined by the impact on German competition of the restraints concerned, while it is immaterial whether the seat of the parties to the restrictive agreement is located abroad or whether the locus where the agreement was concluded is situated outside Germany.

Hitherto the Bundeskartellamt has not basically clarified its position on Article 98 Section II. Its views in this respect can only be ascertained on a case-by-case basis. One may conclude from such cases that it holds the Act applicable to those restraints of competition initiated by foreign enterprises abroad which have no domestic establishment or other footholds in Germany nor carry on business activities there. On the other hand the question of the meaning of the concept 'effect within the territory for which the Act is operative' does not yet seem to have been settled.[111]

Besides the issue of the legal scope and applicability of the Act there is the question to what extent the German Government uses its powers under the Act. Here one should distinguish again between the assertion of jurisdiction and the power to enforce compliance to the Act.

At the time the bill was discussed before Parliament the debates with the German Government on Article 98 Section II centred mainly on the question of its jurisdictional competence. The Committee on Economic Policy of the Bundestag clarified its position on this issue as follows:

> In point of fact the power of intervention of the anti-trust authorities against such restraints of competition will depend upon the presence within the territory, for which this Act is operative, of legal representatives, proxies or agents of the parties to such agreements, or upon the fact that the parties participating in the agreements are subject to the jurisdiction of the Bundesrepublik pursuant to the principles of international law, or that the agreements are governed by German law.[112]

The Kartellamt has hitherto moved very cautiously in enforcing the Act. No coercive measures against foreign companies abroad have yet been taken.[113] Thus the application of the German Act against Restraints of Competition has never given rise to any serious controversies with other states or complaints from foreign enterprises.

In Austria, the Cartel Act lays down in its Article 2, Section 1 that it is applicable to cartel agreements concluded abroad only in so far as they are implemented in Austria itself. Consequently a strict territoriality principle prevails in the implementation of Austrian cartel law,[114] and so the extra-territoriality issue is not likely to arise. Actually the Act has not yet been applied to foreign enterprises.

Since 1945 the US authorities have consistently given their anti-trust laws extra-territorial application.[115] This stems from the fact that the Sherman Act covers restrictive practices that affect 'trade or commerce ... with foreign nations', and that the US authorities apply the objective territoriality principle that was recognized in a case of manslaughter in the well known Lotus case.[116] The American position was neatly defined by Judge Learned Hand in the Alcoa Case[117] as follows:

> It is settled law ... that any State may impose liabilities even upon persons not within its allegiance for conduct outside its borders that has consequences within its borders which the State reprehends.

US anti-trust law therefore makes in this respect no difference in the treatment of US nationals and foreigners.

US courts can of course assert jurisdiction over domestic enterprises (in personam jurisdiction) and are entitled according to the active personality principle, recognized in public international law, to assert jurisdiction over the conduct of these enterprises abroad (subject matter jurisdiction). This assertion of jurisdiction is, however, restricted in so far as the national courts may not exact conduct from the nationals under their jurisdiction which is in conflict with the public policy of the foreign State, in which these acts are to be performed.[118]

For the US courts to assert jurisdiction over foreign enterprises (in personam jurisdiction), the latter must be found in the USA or must do business there, so that if an enterprise has made direct investments in the United States it easily becomes subject to the juris-

110 Müller-Henneberg-Schwartz, *Gesetz gegen Wettbewerbsbeschrankungen und Europäisches Kartellrecht* (2. Edition, 1963), p. 1169; Eugen Langen, *Kommentar zum Kartellgesetz* (1958), p. 410; E Rehbinder, *Extra-territoriale Wirkungen des deutschen Kartellrechts* (Baden-Baden, 1965), p. 107; I. Schwar, *Deutsches Internationales Kartellrecht* (1962), pp. 22/8, in particular p. 24.

111 K Markert, 'Die Anwendung des Gesetzes gegen Wettbewerbsbeschränkungen auf internationale Wettbewerbsbeschränkungen' in *Zehn Jahre Bundeskartellamt, Beiträge zu Fragen und Entwicklungen auf dem Gebiet des Kartellrechts* (Carl Heymanns Verlag KO, 1968), pp. 209–12.

112 Report D. Bt.-Committee, 2. Wahlperiode 1953, Annex to *Bt.-Drucksache 3644*, p. 40.

113 K Markert, loc. cit., pp. 227-8.
G Jaenicke, *ILA Conference Report* (Helsinki, 1966), p. 93.

114 F Schönherr, *Oesterreichisches Kartellrecht* (Brüder Hollinek, Wien, 1966), pp. 12/13.

115 The factual data on this theme have largely been taken from the International Law Association Conferences' Reports of 1964 (Tokyo), 1966 (Helsinki) and—as far as available—1968 (Buenos Aires), as well as from the paper by J J A Ellis, 'Legal Aspects of European Direct Investments in the United States of America' presented to the Conference of The Atlantic Council (May 1969).

116 *P.C.I.J.* Series A, No. 10, p. 18.

117 *US v. Aluminium Company of America et al.*, 148 F. 2d. 416 (1945).

118 Verzijl in 'The Controversy regarding the so-called Extra-territorial effect of the American Antitrust Laws', *Ned. Tijdschrift voor Int. Recht* (1961), does not accept this restriction.

diction of the US courts.[119] Once this relationship with the American economy is established the foreign enterprise must seriously take into account that it may expose itself to the extra-territorial application of US anti-trust laws in respect of its non-American operations (subject matter jurisdiction).

The issue of the extra-territorial application of US anti-trust legislation to aliens is a controversial one, especially where subject matter jurisdiction is involved. It does not seem appropriate to start a legal discussion here on the issue of whether such application is permissible under the principles of international law or not. Suffice it to say that Section 18 of the [illegible] case law. The European Advisory Committee on the Restatement under the chairmanship of Lord McNair, asked by the American Law Institute for its opinion, dissented in stating:

> In our view the exercise of jurisdiction based on territory is not justified in cases where all that has occurred within the territory is the effects of certain conduct and not at least part of the conduct itself.

At the international level, the international law aspect of the extra-territorial application of anti-trust laws is being studied by the International Law Association. It accepted in 1964 a resolution pointing out that international law does set limits to the jurisdiction of individual states.[120] The issue seen from the point of view of public international law is thus still unsettled.

In the US the view is invariably taken that:

> each State is authorised to make—and, when it has effective control to apply—law for events, even when occurring beyond its territorial boundaries, which substantially affect its own community process.[121]

This practice, however, encountered opposition from the governments of the countries within the [illegible] in question. Sometimes this opposition has taken the form of official protests filed with the US Department of State by the governments involved. The impressive list of protests, in so far as they have been made public, include those lodged by the governments of Denmark, Norway, Sweden, Finland, Switzerland, the United Kingdom, Ireland, Canada, India, Germany, Italy, France, Belgium, the Netherlands, Japan and Jugoslavia.[122]

Such reactions cannot be considered in themselves as an adequate solution to these controversies since the considerations on whether or not to lodge a protest are more often than not based on policy decisions in which elements unconnected with the issue itself play a significant part.

An illuminating example of this is shown by the events connected with the decision of the US Court of Appeals of 26 June 1968 in the matter of the Grand Jury Subpoena addressed to the First National City Bank.[123] Here the Frankfurt branch of the Bank was ordered to produce documents on the business transactions of its German client Boehringer & Soehne. The Bank argued that, although such production was not prohibited in Germany by a penal statute, it would amount to a breach of the Bank's contractual obligations toward his client, and violation of bank secrecy could subject the Bank to liability in contract or tort. The Appellate Court decided that the mere absence of criminal law abroad was not in itself decisive, because the vital national interest of a foreign nation could be expressed in other ways. The Court found, however, that in the matter of bank secrecy there had not been a clear and firm expression of public policy by the German Government, which had not lodged a protest with the US Government[124] either. One may wonder what the reaction of the German Government would have been if no subsidiary of an American bank had been involved, but if such an order had been addressed to a genuine German bank.

Perhaps the governments themselves have realized that the case-by-case reaction by way of protests was not the right response to this challenge. Some of them have proceeded to the enactment of laws to protect themselves against the intrusion of foreign law and foreign policy in this field. Such protective legislation has been adopted by Denmark, Finland, France, the Netherlands, Norway, Sweden and the United Kingdom, and in the Canadian Provinces of Ontario and Quebec. Some of these laws, like the one in the Netherlands,[125] prohibit compliance with any type of [illegible]

The Watkins Report proposed to the Canadian Government the introduction of legislation prohibiting compliance on Canadian territory with any anti-trust order made by any foreign authority without previous permission being granted by the Canadian Government. This was in spite of the existence of an informal arrangement between the US and Canada, the Anti-trust Notification and Consultation Pro-

119 *US v. Scophony Corp.*, 333 US 795, 1948; *US v. US Alkali Exp. Ass.*, CCH Trade Cases 1946-7, par. 57,481; *US v. Imp. Chem. Ind. Ltd*, 100 F. Supp. 504, SDNY 1951; *US v. Watchmakers of Switzerland*, 133 F. Supp. 40, SDNY 1955; *in re Electr. & Musical Ind. Ltd*, 155 F. Supp. 892, SDNY 1957, *in re Siemens & Halske A.G.*, 155 F. Supp. 897, SDNY 1957.
120 *Report of 51st ILA Conference* (Tokyo, 1964), pp. xxviii–xxix.
121 Prof. M S McDougal in *Report of 51st ILA Conference* (Tokyo, 1964), p. 330.
122 *Report of the 51st ILA Conference* (Tokyo, 1964), pp. 403–5 and pp. 577–88.

123 *In Re Grand Jury Subpoena addressed to First National City Bank*, 396 F. 2d. 897 (CA-2 1968), CCH Trade Cases 1968, par. 72,507.
124 It may be interesting to note that Boehringer & Soehne, who were involved in the penal proceedings in the US (and in the EEC) against the international quinine cartel, did not move either.
125 Economic Competition Act of 1956, Section 39.
126 As in the United Kingdom, which enacted the Shipping Contracts and Commercial Documents Act in 1964 (Section 2).
127 As in France which issued the Law No. 68-678 of 26 July 1968 on 'La communication de documents et renseignements à des autorités étrangères dans le domaine du commerce' (*Official Gazette* of 27 July 1968, pp. 7,267).

cedure dating from 1959—the so-called Fulton-Rogers agreement—which, however, according to the Watkins Report, 'ha(s) been relatively ineffectual in blocking this erosion of Canadian sovereignty'.[128]

Not only the policy-making authorities and the legislative authorities but also the judiciary have taken issue with the extra-territorial application of US anti-trust law. In this connection the British Nylon Spinners Case[129] may be recalled, which originated from the injunction of the US judge to ICI to reassign to Dupont some UK patents held by ICI[130] under which ICI had licensed BNS. BNS promptly sued ICI in the UK courts and obtained an order prohibiting ICI from complying with the order of the US court. The UK judge held: 'I certainly would be the last to indicate any lack of respect for any decision of the district courts of the US but I think that in this case there is raised a somewhat serious question whether the order in the form that it takes does not assert an extra-territorial jurisdiction which the courts of this country cannot recognize notwithstanding any . . . comity. The writ of the United States does not run in this country.'

One may wonder why these conflicts, resulting from the assertion of jurisdiction over conduct abroad by one government and the attitude of the other governments insisting upon their sovereignty, have become such a hotly contested issue. Some deep-rooted reasons lie at the heart of this controversy.

First of all there is a conflict of an ideological character, in that—contrary to the other countries—free competition is held in the US to be an end in itself. This aim has been embodied in the law and the judiciary accordingly enforces competition. Not without reason the White House Task Force Report on Anti-trust Policy[131] started with the words: 'The anti-trust laws reflect our Nation's strong commitment to economic freedom and the material benefits that flow from this freedom.'

In the other countries, however, competition is considered to be one of the means of achieving the manifold goals of economic policy pursued by the governments.[132] These objectives—balanced economic growth of the national economy, full employment, price stability, equilibrium of the balance of payments and an equitable distribution of incomes—do not have as their sole and ultimate goal to 'yield the best allocation of our economic resources'[133] which is the purpose anti-trust laws are designed for. Under certain present circumstances the pursuit of these economic objectives is furthered, but also sometimes thwarted, by unrestricted competition. Public policy then is alive to the fact that competition should not be pushed to its extreme and even that restraints on competition are inevitable.

Therefore the acceptance of per se violations for certain restrictive business practices hardly seems consonant with a European ideology on competition. It is recognized in the US that efforts to co-ordinate strong anti-trust enforcement with such other unrelated policies as balance of payments equilibrium might result in distortion of anti-trust law.[134] To give in to such consequences could hardly be compatible with the US anti-trust philosophy. As it is, the fundamental attitude of the place and function of competition in the economy is here at issue. This is conditioned by the temperament, the tradition and history of the people as well as by the development of the nation concerned.

It is the contention in the US that this fundamental attitude towards competition in the other countries will evolve and will 'elevate' their standards[135] in the course of time in the direction of the US ideology. That expectation has been expressed in a number of statements, inter alia by Prof. Schwartz, who held that: 'With the rapid recent development of anti-trust in other countries we may soon see the development of governmental collaboration in supply of information necessary to the control of international cartels.'[136] And Mr Zimmerman, then Acting Assistant Attorney General, stated that 'with the growing and developing interest in anti-trust on the part of a number of European countries we have been consulted . . . for advice and guidance; and I think in part this refers to the prospective legislation of various countries'.[137]

The second reason for the conflict is that anti-trust law and policy are always tailored to national needs only. Each country organizes its markets in the manner which provides the optimal results for its national economy. Anti-trust laws of the various governments and their application are thus by definition parochial in character. Not a single country makes an exception. In this connection it is worth noting that American enterprises can be authorized under the Webb–Pomerene Act to conclude export cartels.

Since national policies diverge, the conduct of enterprises is contemplated by the various governments from different angles, viz. in the light of the harm they do or the contribution they make to the respective national economies. Consequently the assessment of such conduct by these various governments may be diametrically opposed. It is therefore quite understandable that the various governments should prohibit, as well as permit the same conduct, even if the ideological attitude towards competition as such were not so much at variance. Both are

128 *Watkins Report 1968*, p. 390.
129 *British Nylon Spinners Ltd v. Imperial Chemical Industries Ltd* (1953) 1 Ch. 19 (CA 1952).
130 *US v. ICI*, 105 F. Supp. 215, 237 (SDNY, 1952).
131 This Report of 5 July 1968 to the US President was released by the Department of Justice on 21 May 1969. It examines anti-trust policy and contains recommendations for new anti-trust legislation.
132 Zijlstra and Goudzwaard, 'Economic policy and competition problems in the EEC and the member States', *Studies, Series on Competition No. 2.* Edition European Economic Community (1966).
133 *Northern Pacific R. Co. v. US*, 356 US 1, 4 (1958) as well as the *White House Task Force Report* (p. I.1), which used the same language.
134 J C Scott and S K Yablonski, 'Transnational mergers and joint ventures affecting American exports', *The Antitrust Bulletin*, Vol. XIV, Spring 1969, p. 33.
135 S E Rolfe, *The International Corporation* (1969), p. 82 (ICC Background Report).
136 Schwartz, *Report of the 51st Conference of ILA* (Tokyo, 1964), p. 328. Reprinted in *International Aspects of Antitrust*. Hearings before the Subcommittee on Antitrust and Monopoly of the US Senate Committee on the Judiciary (1966), p. 549.
137 *International Aspects of Antitrust*, Hearings, ibid. (1966), p. 497.

expressions of a policy decision, since a permissive attitude need not be an expression of indifference but can imply a favourable disposition even to the extent that it supports and promotes such behaviour.

Even if the policies of various governments in a particular case were to coincide, a government would still resent it as an intrusion upon its own sovereignty if a foreign governmental authority were to address orders directly to the former's subjects residing within its boundaries, enjoining a certain market conduct in that country. The Watkins Report supports this view:[138] 'Whether a decree of a US court does or does not help to maintain competition in Canada . . . is [illegible] Canadian policy without the undesirable political costs.'

In several cases where the decisions of the US courts on the extra-territorial application of anti-trust law have met with resistance from governments abroad, the courts have taken these reactions into account up to a certain extent. Thus after the intervention of the Swiss government in the Swiss Watchmakers Case the [illegible] such as has occurred in the litigation of the past when there was believed to be a possible conflict between a decree of a US court and the sovereignty of a foreign nation'.

To prevent enterprises from being caught between two contradicting legal obligations the US courts have inserted saving clauses in their decisions to exclude the requirement of conduct abroad contrary to the law of the country where it had to be performed. Some saving clauses also provided that certain injunctions should not apply where the prohibited act was made pursuant to a request or official pronouncement of policy of the foreign nation and where failure to comply with the request or policy would entail the risk of the present or future loss of the particular business in such foreign nation.[139]

There is a special aspect to the extra-territorial application of anti-trust which is of particular importance to international firms since as a consequence thereof the entire international corporation is regarded as subject to the jurisdiction and policies of the US government in this field.[140]

No parent company located in the US can afford to permit either itself or its foreign subsidiaries to avoid compliance with the US anti-trust laws. The governmental directives or instructions issued to the parent may require a certain conduct from its subsidiaries or branches abroad involving perhaps the production of certain documents in the possession of the subsidiary. These orders would be passed on abroad through the ordinary channels of communication within the international company without any publicity. Such orders on conduct and investigations can also extend to the affairs of aliens.

This required conduct of the subsidiary may be at variance with the policies of the government of the host country, which will certainly resent it all the more if the affairs of its own nationals are thereby affected. The subsidiary finds itself in a serious dilemma but will generally have to yield to the pressure of its head office, at the same time running the risk of injury to its local status.

When the US head office of an international corporation yields to unofficial pressure from the government, even the existence of protective legislation abroad is of no avail since there the issuance of an official order is always required for its application.

For the host country this kind of cold extra-territoriality is a reason for concern. Often it may not even be aware of the source of the foreign impact on its policy which is exercised through the internal channels of the international corporation. It may even be unaware of what is happening—e g. the production of documents—until the results of the acts have come into the open. As the Watkins Report puts it: 'From the viewpoint of the host country the extra-territorial extension of law is an undeniable cost of foreign direct investment.'[141] But it is not only the host country that is involved. The international corpora- [illegible]

A situation may also present itself where the US government approaches the US-based subsidiary of an international firm to pass on to its head-office the government's request for the pursuance of certain conduct or the disclosure of certain information abroad, either by the head office itself or by another subsidiary belonging to the international firm located in another host country. It may be that policy considerations motivate the international company to accede to these requests. Such a situation might bring it into conflict with the public policy of the government of its home country, or might raise serious difficulties in its relationship with the host country where the other subsidiary is based.

VI.B Extra-territorial application of US anti-trust law to mergers abroad where American firms are involved

[illegible] state:[142] 'The relationship of this important Section (7 of the Clayton Act) to foreign trade has not yet been tested but the above definition of "commerce" (in Section 1) would indicate that it is applicable,' this assumption is now generally accepted as a certainty.

The first case where the Clayton Act was applied

[138] *Watkins Report*, Chapter II, Section 7, Nr. 48.
[139] *US v. Standard Oil Co. (NJ)*, CCH Trade Cases 1960, par. 69, 849 (SDNY, 1960).
[140] S E Rolfe, op. cit., p. 79.

[141] *Watkins Report*, p. 49.
[142] Fugate, *Foreign Commerce and the Antitrust* / (more detailed on pp. 249 ff.).

to a foreign merger standing alone involved a decision in the Schlitz case.[143] Here Schlitz acquired a Canadian company which owned a brewery in the US. This brewery was held to be in competition with Schlitz in the US. Therefore although a foreign acquisition was involved it was domestic US commerce which was restrained. Thus the relationship of Section 7 of the Clayton Act to foreign trade was not settled by this case.

The second case concerns the Gillette-Braun case.[144] No decision has yet been reached in this case. Early in 1968 the Department of Justice filed an injunction suit under the Clayton Act assailing Gillette's stock acquisition of the German Braun company. The complaint charges among other things that the intended merger would eliminate potential domestic competition among both companies because Braun may potentially enter the US market if its license to Ronson should end, or Gillette may potentially enter the electric shaver business. If the government prevails in its potential competition argument the opportunities for US companies to effect a merger abroad will be seriously limited if the acquired company is a potential exporter to the US or the US company is a potential manufacturer of goods that compete with those of the acquired company abroad.

Other proceedings challenging foreign acquisitions standing alone have been initiated, such as the Litton Industries Inc.-Adler/Triumph case[145]—started by the Federal Trade Commission—but not enough details have as yet transpired for more guidance to be given on the interpretation of Section 7 of the Clayton Act.

Previously, foreign acquisitions were assailed incidentally in litigations aimed at broad anti-competitive patterns of conduct of which the acquisitions constituted only a part. All these cases were adjudicated under Section 1 of the Sherman Act. In the Minnesota Mining case,[146] where a joint venture in production abroad was set up for serving the internal market of that foreign country, it was held that such act may be illegal per se because this joint operation abroad was undertaken by dominant American manufacturers and consequently 'may inevitably reduce their zeal for competition (among themselves) in the American market'. In the National Lead case[147] and the ICI case,[148] joint ventures abroad were attacked as part of an overall cartel agreement. The termination of joint foreign interests was ordered.

In the Timken case[149] the American Timken Company held 30 per cent of the shares of Timken Ltd (British) and 50 per cent of the shares of Timken Française. Agreements were concluded between the three companies providing among other things for the allocation of sales territories. The lower court held this arrangement to be illegal per se since the same rule of illegality per se should be applied to foreign trade as to internal trade. American Timken was forbidden to fulfil its contracts, so that it had to compete with British Timken and French Timken. The divestiture order, however, was not upheld by the Supreme Court, which found it 'unduly harsh'.

In the consent decree entered into in 1960 in the Standard Oil Company (New Jersey) et al. case[150] it was determined that the Government would not seek relief against so-called 'producing joint ventures', meaning that these only sell to participants in the joint venture, as distinct from so-called 'marketing joint ventures', i.e. those that also sell to the public or to non-participants in the venture, which the Government insisted be terminated. The producing joint ventures in question were Aramco in Saudi Arabia, and the Iraq Petroleum Corporation, a joint venture of American, British and French oil companies. The legality of these joint ventures was recognized. This shows clearly that the existence and operation of joint ventures under certain circumstances are permitted and no per se illegality is involved.[151]

The position for US companies envisaging a merger abroad is, however, still far from clear. The argument that the use of foreign factories has increased the movement of raw material from American to foreign shores, which should be set off against the finished products potentially exported, was countered in the Minnesota Mining case by the finding: 'It is . . . significant that Congress has not said you may choke commerce here if you nourish it there.'

No wonder that Dean[152] pleads for a policy permitting activities abroad that result from the manner in which business is conducted in the particular country concerned, or that are taken as a practical necessity to compete in foreign markets even though such activities may have some effect on US commerce.

On the other hand Mr Zimmerman,[153] then Acting Assistant Attorney General, suggested at the Subcommittee hearings in August 1966 that the central criterion for determining whether or not anti-trust prosecution will be brought against acquisitions or joint ventures abroad is simply whether the activity has or is likely to have a substantial adverse competitive effect on American commerce. In view of the prevailing perplexities that currently beset American

143 *US v. Jos. Schlitz Brewing Co.*, 253 F. Supp. 129 (N. D. Cal. 1966), aff'd per curiam, 385 US 37 (1966).
144 *US v. Gillette Co., CCH Trade Regulation Reporter 1968*, par. 45,068 Case 1988 (D. Mass. 1968).
145 It was announced that FTC had decided not to seek a preliminary injunctive relief after negotiating a protective agreement with Litton designed to preserve Adler-Triumph as a sufficiently separate entity, *CCH Trade Regulation Reporter*, 1969, par. 18,828.
146 *US v. Minnesota Mining & Mfg. Co.*, 92 F. Supp. 947 (D. Mass. 1950).
147 *US v. National Lead Co.*, 63 F. Supp. 513 (SDNY, 1945); 332 US 319 (1947).
148 *US v. Imperial Chemical Industries Ltd*, 100 F. Supp. 504 (SDNY, 1951); 105 F. Supp. 215 (1952).
149 *US v. Timken Roller Bearing Co.*, 83 F. Supp. 284 (N. D. Ohio 1949); 341 US 593 (1951).
150 *US v. Standard Oil Co. (NJ) et al.*, CCH Trade Cases, 1960, par. 69,849 (SDNY, 1960). On 24 January 1968 the Department of Justice moved to dismiss its 1953 civil anti-trust suit against Standard Oil (Cal.) and Socony Mobil and made various changes in the consent decrees previously entered into with Standard Oil (NJ), Gulf and Texaco.
151 J C Berghoff, 'Antitrust Aspects of Joint Ventures', *The Antitrust Bulletin*, Vol. IX, No. 2, 1964, p. 231.
152 Dean, 'The Impact of Anti-trust Regulation upon the Multinational Corporation', *SAIS Review*, 1969, Vol. 13, No. 2, p. 6.
153 *International Aspects of Anti-trust*, Hearings before the Subcommittee on Anti-trust and Monopoly of the US Senate Commission on the Judiciary, 89th Cong., 2nd Sess., 30 August 1966, pp. 489–91, 508.

enterprises engaging in merger activities abroad, it might be commendable if in their behalf the US Department of Justice, when re-editing its Merger Guidelines of 30 May 1968, would include a section devoted to mergers abroad in order to explain its enforcement policy under Section 7 of the Clayton Act in that respect.

VI.C Extra-territorial application of US anti-trust law to mergers abroad among non-American firms only

Since the extra-territorial application of American anti-trust law makes no difference in the treatment of US nationals and aliens it might not be too exaggerated to assume that the Clayton Act may also be implemented against acquisitions and amalgamations abroad by two non-American firms.

In point of fact, from the testimony of Zimmerman,[154] Section 7 of the Clayton Act seems wide enough to be applied to amalgamations and acquisitions abroad even as between two non-American companies if a substantial restraint of US commerce results from the merger. This view is now liable to be tested, since the proposed merger in Switzerland between the two pharmaceutical firms Ciba and Geigy is currently being delayed because of the possible impact of Section 7 of the Clayton Act. A merger or acquisition cannot only be prohibited from its inception by the Clayton Act but it can also be attacked many years after it has been in operation. The Mobay case[155] is a good example. Here a joint venture between Monsanto and Bayer came under fire. The case, which had started in 1964, was settled by a consent decree entered into in 1967 involving a divestiture of Monsanto, while the joint venture had

Clayton Act does not apply only in those cases where there is actual competition that may be substantially lessened, but also where the courts find that there is a reasonable probability that any one of the companies involved would have entered the market alone with the other remaining a significant potential competitor.[157]

If the relevant Section of the Clayton Act were construed to cover conglomerate mergers as well, this interpretation could equally be applied to similar merger operations undertaken by non-American companies abroad when those activities involve a substantial restraint of US commerce. Such cases can arise if the merging partners each possess US subsidiaries whose import and export trade pattern could

would imply that American authorities could order the divestiture of a merger or acquisition abroad undertaken by non-American enterprises which are potential competitors among themselves or not even competitors at all This order could be given and—where no relevant defensive legislation exists—indirectly enforced by a remedial injunction in the USA,

operation as beneficial to its national economy. This situation is bound to become a source of new conflicts between the governments involved.

VI.D Can a solution be found to the conflicts?

The conflict which arises out of the assertion of extra-territorial jurisdiction on the one hand and the proclaimed infringement of sovereignty on the other, leads to a situation which is unsatisfactory for all the nations concerned But the same applies to the interest of the international corporation, which may be squeezed between two contradicting governmental policies. Therefore, a pressing need exists for an international solution to be found between the OECD member States

In the past the OECD organization has already played a role in settling conflicts that had arisen out of the Federal Maritime Commission's investigation (1960/61) in which shipowners of various European states were requested to produce documents and information This action provoked diplomatic protests from the Governments concerned In December 1963 the Ministers of the European Governments involved issued a press release[159] which included the following statement:

> . . . They regard the Federal Maritime Commission's request to European shipowners to produce under threat of penalties documents and information outside the jurisdiction of the US as an infringement of their countries' jurisdiction Ministers decided that the matter should be taken up in the OECD.

As a result the European Governments involved conducted negotiations with the Government of the United States under the auspices of the OECD On

statistical information on specific items in aggregate form relating to the Shipping Conferences This information would be forwarded to the OECD which would circulate the copies among its member governments The European Governments declared that this co-operation was wholly without prejudice to their known jurisdictional and other objections to a number of features of US shipping legislation and to the procedure and activities of the Federal Maritime

US Shipping Act of 1916 to obtain such information by proceedings in US courts. The US Government also

[154] Ibid., p. 491.
[155] *U.S. v. Monsanto Co., Bayer AG and Mobay Chemical Co.*, CCH 1967 Trade Cases, par. 72,001 (W. D. Pa. 1967)
[156] *International Aspects of Anti-trust*, US Senate Hearings 1966, p. 498.
[157] *U.S. v. Penn-Olin Chem. Co.*, 217 F. Supp. 110 (D. Del. 1963), 378 US 158 (1964), 246 F. Supp. 917 (1965), 387 US 906 (1967)

[158] *Report of 51st ILA Conference* (Tokyo, 1964), p. 568.
[159] *Dept. of State Bulletin*, Vol. LII, No. 1337 of 8 February 1965, p. 188 (Press release 7, dated 18 January 1965).

agreed to consult with the European Governments before using information or documents in formal proceedings before the Federal Maritime Commission.

The work on co-operation between the OECD member countries in this field was continued. On 5 October 1967 the OECD Council adopted—with the abstention of Switzerland—a Recommendation[160] designed

(a) to introduce a notification procedure under which a country undertaking an investigation or a proceeding gives notice to another member country if thereby the latter's important interests are involved, and
(b) to arrive at an exchange of information on restrictive business practices in international trade in so far as laws and legitimate interests permit their disclosure, while equally
(c) providing for a co-ordination of efforts in dealing with international restrictive business practices on a fully voluntary basis.

It is not without significance that the Recommendation contained the following consideration

> ... it being understood that such co-operation should not in any way be construed to affect the legal positions of Member countries, with regard to such questions of sovereignty, and in particular the extra-territorial application of laws concerning restrictive business practices, as may arise.

It may be questionable whether this Recommendation will yield the results that are anticipated. The exchange of information could only be contemplated if the country supplying such information were certain that it would not be used for the extra-territorial application of the national anti-trust laws of the recipient country in a manner incompatible with the public policy of the state that supplied the data. One might better have adopted the formula agreed upon in 1964 in the case of international maritime transport. There a solution was reached which, whilst providing for an exchange of certain information, explicitly safeguarded the position taken by the European countries on the subject of extra-territoriality of national laws. It also protected enterprises against what was seen by the great majority of the member countries of OECD as a non-permissible interference by foreign administrative agencies and contained a guarantee as to the non-disclosure of business secrets.

On the other hand one may wonder whether the co-operation between the member countries in dealing with international restrictive business practices should not go further than a mere notification procedure where the proceeding member country retains full freedom of ultimate decision to take account of such views as the other member country wishes to express.

It seems unrealistic to seek the solution in an attempt by an international convention to establish in this field either a harmonized substantive law or to define the limits of national jurisdiction based on principles acceptable to all the participating states concerned, since the underlying anti-trust ideology differs substantially. At the same time all the national laws are tailored to meet the requirements of the economy of each individual country, and, public policy in this field being parochial by nature, their implementation is equally designed to further purely national economic objectives, which may deviate from country to country. In addition, as long as centralized jurisdiction is lacking, there is no guarantee that a convention containing substantive law on restrictive business practices or a delimitation of national jurisdiction would be implemented in a substantially equal way in the various countries. Thus a discriminatory enforcement of such a convention could not be prevented.

Therefore, consideration might usefully be given to the system already established in the European Free Trade Area where in October 1965 a flexible consultation procedure between the member States[161]—the so-called 'Copenhagen procedure'—was adopted, amplifying the rules to that effect embodied in Article 15 of the Convention creating the European Free Trade Association. By analogy with this procedure it may be useful for the OECD countries to consider the adoption of a convention by virtue of which any State having a complaint about restrictive business practices that have a substantial harmful effect upon its national economy, and which are performed within the borders of another OECD State, should first—before trying to seek a unilateral remedy—try to resolve the matter with the other member State concerned through direct consultations.

Should no satisfactory settlement be reached, then the complaining State may—by analogy with what is provided for under Article 31 of the EFTA convention—refer the matter to the Council of Ministers of the OECD for examination upon which the latter can formulate a recommendation. In any such recommendation the Council may provide for the publication of a report on the circumstances of the subject matter.

In the framework of the EFTA treaty certain complaints have been discussed bilaterally and solutions have been found without having to invoke a formal procedure for submitting the matter to the EFTA Council of Ministers. Bearing in mind that this kind of procedure has shown some promising results, it might be worth while extending this kind of procedure to the OECD States. Since the OECD organization comprises the members of EFTA as well, the latter might give some useful advice on how to set up the most appropriate system and how to avoid pitfalls they have encountered.

This system of consultation will, of course, not settle all existing problems, but it would go a long way towards preventing a unilateral extension of the reach of the municipal law on anti-trust within the borders of another State and the inherent intrusion upon its sovereignty. With the ever growing interdependence of the national economies, it seems anomalous that

160 *OECD Document C*(67), 53 Final of 10 October 1967.
More detailed: K Markert, 'Recent developments in international antitrust cooperation', *Anti-trust Bulletin*, Vol. XIII, Summer 1968, pp. 361 ff.

161 Cf.: EFTA-Doc. No. 47/65 of 29 October 1965; H Wiebringhaus, 'Le Droit des Ententes dans le cadre de la CEE et de l'EFTA', *Revue du Marché Commun*, 1966, p. 763.

one State should try to impose unilaterally its own national economic policy on those of others [illegible]

[illegible] international corporation would be better off if it were confronted with an international economic order where political powerplay[163] were replaced by intergovernmental consultations.

VII THE FUTURE OF THE INTERNATIONAL FIRM

When probing into the future and trying to assess the future profile of the international firm one should be aware that such a venture is highly speculative and bound to be controversial. It is moreover inevitable that any venture into the field of futurology involves subjective elements and that therefore the scientific standards of objectivity—although one should try to adhere to them as much as possible—cannot be upheld to their fullest extent. Nonetheless it seems appropriate in the context of this paper to deal with this issue because the position of the international firm in the industrialized world of tomorrow will highly influence the orientation of future governmental policy towards it and vice versa.

Several authors have already dealt with the question of the future position of the international corporation. One of them, Prof. Perlmutter,[164] comes to the plausible conclusion that towards the end of this century no more than some 300 giant international enterprises will be left. The dominant influence in [illegible]

[illegible] of the nation state with this concentration of economic power, and adding a special dimension to this relationship

When dealing in this context with the issue of economic power two essential factors should be borne in mind. Firstly, economic power in itself has two aspects: the objective one, whether one is in such an autonomous position that one can exert power on [illegible]

[illegible] which determines greatly the attitude towards economic power.

Secondly, in order to put the issue of economic power in its proper perspective, one should not simply extrapolate the concentration movement into the future and suppose that all the other elements of our industrialized world will not evolve. That is a misconception. For a correct assessment of the future all developments in society—social, economic and political—that have a bearing on the issue at hand should be extrapolated as well.

VII.A The characteristics of an affluent society

One should therefore try to envisage the environment of the future in which the international firm will operate, the affluent society of tomorrow which will [illegible]

[illegible] will be extended not only because industry will mainly require highly qualified labour [illegible]

[illegible] pensionable age will be earlier, while the average life expectancy will be lengthened thanks to improved medical care and advances in the field of medicine, so that those not gainfully employed at all will represent the major part of the population. All this allows the conclusion that the relative importance to man of work in an enterprise is diminishing

Partly because of this change in people's preferences, but mainly because of the enormous increase in productivity, a smaller percentage of the working population will be employed in the manufacturing and the extracting industries, the secondary sector. Consequently in the post-industrial society of the future there will be a basic shift of salaried occupations towards the tertiary sector, i. e. towards those industries that provide services mainly to the first two sectors, like banking, insurance and transport, and particularly towards the quaternary sector, i. e. towards those service activities that provide for the recreation of the population at large as well as for their social welfare, and which will show the greatest employment growth rate. Governments are now already participating actively in this quaternary sector, as for example in the arts, cultural activities, broadcasting, television and medical care. It can be [illegible]

[illegible] diminishing relative

[illegible] Quarterly, Winter 1968.

165 H. Kahn and A. J. Wiener, *The Year 2000* (The Macmillan Co., New York, 1968), pp. 62–3.

importance man attaches to work in an enterprise and the declining importance of the secondary sector, will bring with it a change and a break away from today's pattern of values. The production of material goods in a society of plenty will no longer be evaluated as the dominant source of our prosperity but as the self-evident task of an enterprise. The undertaking of an industrial venture will no longer be the challenge it represents for many nowadays.

It was Galbraith[166] who held that 'we may, over time, come to see the industrial system in fitting light as an essentially technical arrangement for providing convenient goods and services in adequate volume'. In the same vein Kahn and Wiener[167] predict that '. . . the issues of finance, investment, production, sales and distribution that have so long been dominant concerns of so many Americans and Europeans will very likely dwindle in interest'. This entails a change in appreciation towards those who are connected with these activities.

VII.B The future role and function of the entrepreneur

The one most intimately involved in business activities is the entrepreneur. Inevitably his function of an autonomous nucleus in our society, acting as an innovator, a risk-taker and leader of an organization will change. This autonomy is—as set out before—the objective basis of the entrepreneur's economic power. But what about half a century from now?

Although the entrepreneur will undoubtedly retain his innovating function, governmental interference will cause it to be less often an autonomous one. At the present time industries with an advanced technology, like the space and nuclear engineering industries, are a domain in which governments themselves are already actively engaged or where there is close co-operation between government and private enterprises.

Moreover governments are taking a growing interest in the structure and performance of industry in general. Thus governments participate actively in the restructuring and stimulation of those branches—for instance through an ever increasing volume of development orders—which they deem of vital or basic interest to the national economy, while at the same time temporizing the transition in the stagnant sectors. There is no reason to believe that such interest will slacken in the course of time. On the contrary, governments will be seen taking an ever increasing part in actively stimulating and directing entrepreneurial activities. But this implies at the same time a proportionate lessening of the autonomous innovating function of the entrepreneur.

Other sources of inventions and of innovation will emerge. The universities with their research facilities will assume enormous dimensions in proportion to the unprecedented growth of educational facilities. Government controlled research and development institutes—now already of great importance in Sweden—will be more widespread than ever before. Thus the entrepreneur will share his innovating function with others in the society of the future. This will not contribute to a strengthening of his position either.

His risk-taking function will diminish since a more sophisticated governmental and intergovernmental macro-economic interference in the economy, for instance by controlling the trade cycle and long-term planning,[168] will lessen markedly the external risk factors.

Moreover, economic and social sciences will have advanced to such a degree that planning will be able with more certainty than today to forecast future developments, or changes in development. In this field, too, the relationship between the nation state and the enterprise will change in that the interaction between them will increase. For determining their business policies enterprises will recognize their dependence on the state's activities. Closer relations with the government for obtaining information will undoubtedly improve the security of business planning even more. On the other hand in determining its own economic policy the government will no longer use exclusively its own parameters but will also need those of the business world. As a consequence there is likely to be a mutual interpenetration of the bureaucracies of state and business organizations.

Today governments take over business risks where these are considered too high or where the financial resources of an enterprise are inadequate to sustain them. The enterprises themselves clamour for such governmental support in the form of orders, guarantees, tax grants and subsidies. Thus, they ask for a lead from the government, instead of undertaking the risks themselves. It is submitted that the shift of business risks on to the government will rather increase than diminish in the future. Its result will be to give the government an even firmer grip on private business operations.

The entrepreneur's function as a leader of an organization will likewise change. The structure of the enterprise will become more and more complex so that the organizing function of the entrepreneur will be replaced by a co-ordinating and therefore less autonomous one. In the future he will as an employer have to deal with people who have received a higher and more extensive education that has broadened their interests and emancipated their views. Since their outlook on life will be quite different from that of people today, the employees' attitude towards the enterprise will be more independent and detached. It will compel the entrepreneur to reconcile the objectives of the enterprise with those of the people working under his management. In this respect he will be acting in much the same way as when he is negotiating with the governments in order to reconcile and co-ordinate the interests of the enterprise with those of the government. In other words, the function that will become more and more important for an entrepreneur is that of reconciliation and co-

166 J K Galbraith, *The New Industrial State* (Hamish Hamilton, London, 1967), p. 399.
167 H Kahn and A J Wiener, op. cit., 1968, p. 187.

168 Cf. K. Mannheim, *Freedom, Power and Democratic Planning* (Routledge & Kegan Paul Ltd, London, 1951).

ordination,[169] internally as well as externally, while in the future economy his function as an autonomous force, as a carrier for wielding economic power, will diminish. In short, his function as an initiator is gradually changing into the function of a mediator.

As a consequence of this decline in autonomy the entrepreneur will come to realize more and more the necessity to orientate his responsibility towards society as a whole. The individual enterprise will become a means of achieving macro-economic and macro-social objectives of a country or group of countries. Since economic growth, increased prosperity, greater social security and well-being are becoming more and more the objectives of the community itself, the entrepreneur will of necessity have to be conscious of his responsibilities in this respect.

In the United States a process of transition from the business as a wholly private, self-serving enterprise to the business as a semi-public, responsible institution in society[170] seems already to be taking place. This movement is implicit in the involvement of business in retraining and educating the unemployable, in restructuring urban poverty pockets, and in providing recreation, education and health facilities for entire communities as well as for their own personnel.[171]

Thus on the one hand government is taking over functions and responsibilities that once were considered typical of business enterprise, while on the other hand business organizations are engaging in activities that were originally seen as belonging to the governmental domain.

VII.C The international firm of the future and its relationship to the nation states

So far we have been dealing with the place and position which the industrial enterprise of the future and its leaders will predictably occupy in the society of tomorrow. Let us now examine Prof. Perlmutter's prophecy that no more than some 300 international corporations will survive as the giants of tomorrow. It is of course anybody's guess how many will actually survive, but it can certainly be taken for granted that the movement towards concentration on an international scale will continue, and that the rate of concentration in those industries that already show a marked oligopolistic structure will increase. But this is not the whole picture. Small and medium sized enterprises will remain in existence. New industries [illegible] international corporations. A case in point is the recent rapid rise of a number of Japanese enterprises that today belong to the biggest in the world. But equally those countries that are currently among the most developed in the less developed areas like Mexico and India, and also Russia and the other Eastern European countries when the political tensions have subsided, may provide the home bases for these international corporations. However all these aspects may be, it is an undeniable fact that the concentration and growth of international enterprises will continue and that the issue of their economic power—by the standards applied today—will persist.

It is evident that the nation state, confronted with this international concentration of power as an [illegible] the imposition of legal constraints, the exacting of certain assurances about the corporation's conduct, the enforcement of state or local private participation or more subtle methods, like subsidies, guaranties and government orders. The greater the interest which governments take in the structure and performance of their domestic industry the more such interference will become a common feature of their policy.

Such action taken by a nation state may in itself induce other nation states to act likewise, if only to protect themselves against encroachments on their sovereignty, since the international corporation might be forced by a foreign nation state to perform acts that have repercussions contrary to their public policy. As an example may be cited the incident [illegible] ciples for Good Corporate Behaviour',[172] which did not directly coincide with the American programme

Such interference from various states in the conduct and operation of an international corporation is liable to prejudice its autonomous decision-making and may lead to a certain degree of disintegration of the international corporation itself Because the various nation states will recognize—as was already pointed out in the *Canadian Task Force Report*—that their interests are to a very large degree in harmony with the objectives of an international corporation, they will not go so far in their requirements as to break up the international corporation into unconnected national parts Where the various national interests clash too violently the various nation states may find it more rewarding to arrive at an international understanding and co-operation. The consultation procedure put forward as a proposal in the sixth chapter of the present paper for the specific field of anti-trust, could perhaps be extended in the future to cover other domains as well, like that of taxes for instance.

Undoubtedly the relationship between the various nation states will also evolve. We may see a further development in the emergence and stabilization of economic blocks, while even the creation of supra-national political authorities in certain areas is not excluded. However, this development will not change

[169] W Brown in *Exploration in Management* (Heinemann, London, 1960), Chapter 17, where this reconciling and co-ordinating function of the manager is extensively described.
[170] W R Dill, 'Business Organisations' in J G March, *Handbook of Organisations* (Rand, McNally & Cy, Chicago, 1965), Chapter 25, pp. 1105–6.
[171] D T Linowes, *Managing Growth Through Acquisition* (American Management Association Inc., 1968), p. 20.

[172] *Foreign-Owned Subsidiaries* [illegible] and Commerce (Queen's Print [illegible] *Watkins Report*, pp. 131–2

fundamentally the issues involving the international firms, since the nation State as their counterparts of today would then be superseded by the supranational authorities of tomorrow.

VII.D Summary and conclusions

In unfolding a picture of the future the point has been made that the first three sectors of our economy will become less and less dominant in our future society, while at the same time the pattern of values dictating attitudes towards entrepreneurial activities will change considerably and the interdependence of the nation state and business enterprises will increase. The international corporations will not constitute an exception in this respect.

In this setting, where the centres of gravity in the affluent society are shifting away from the first three sectors, I cannot do better than to quote Galbraith[173] who held: 'If the industrial system is only a part, and relatively a diminishing part, of life, there is much less occasion for concern.'

The conclusion can be drawn that the fear of the power the giant international industrial corporation could wield if these same conditions existed today, will no longer prevail in the society of tomorrow. It would be a fallacy to assume that the increased amount of material goods produced would give their originators a proportionate increase of power in the society of the future. One may see a community emerging where there will be a closer relationship and co-operation between the nation state and the enterprise and where competition as the force conducive to the allocation of available resources will no longer occupy the place it does today.

The author is indebted to Mr P M P J Merkelbach for his help in preparing the initial drafts of several chapters of this paper, to Mr H W de Jong, now lecturer in economics at the Amsterdam University, for his able assistance and his helpful suggestions, to Mr I Th M Snellen and Mr J J A Ellis, member of the Bar of The Hague, for their support, and to all those who by presenting their constructive and valuable comments have contributed to this paper.

173 J K Galbraith, *The New Industrial State*, p. 399.

4.3 Multinational corporations and restrictive practices

H Kronstein

1 Multinational corporations in their present form and with their present economic influence raise very special problems whenever they are instruments of restrictive market regulations, or whenever governments or other powerful entities undertake restrictive measures; these measures may be in reaction to multinational corporation practices which may have restrictive effects on particular markets.

The present Libyan, Zambian and Peruvian conflicts in the oil and copper fields are developing at the same time, and the United States, the basis of many multinational corporations, is bound to undertake measures restricting trade for the purpose of controlling the present inflatory development.

As a matter of fact, a multinational corporation in which the head company owes loyalty to country A is able to use business entities in many other countries for the purpose of forcing its own trade policy, whether it is altogether extensive or altogether restrictive, or extensive in some respects and restrictive in others. Already in the pre-war period we find a number of American law cases which show that the particular structure of a multinational corporation as an instrument of restrictive or positive market regulation is not a new problem.

Reference is made to the trade policy of the German based dyestuffs industry which controlled, in an extensive or restrictive way, not only the Latin American but also the United States dyestuffs development. A similar case is the trade policy of General Electric and Westinghouse, in their light bulb production, where American based multinational corporations exercised extensive market influence over their dependent corporate entities, especially in England and France.

A decisive difference between the conditions under which these cases developed and the conditions of today has come about by the structure of the 'markets' as well as by governments' policies in regard to market regulation. Today the integration of markets results from technological exchangeability between different processes in different fields, from increasingly faster devices of transportation or communication, from world wide advertising and from the meaning or so-called secondary meaning of trade symbols of many countries and markets. Parallel to this, a market integration very different to the conditions of the pre-war period is due to government interferences in the monetary field in taxes for tariffs as well as local 'trade regulation' in many respects.

Restrictions through enterprises, whether multinational or not, operating in this integrated market, are partly the result of these new market conditions and partly elements of supporting and preparing the development of merging interests among enterprises. A conference devoted basically to a re-examination of the effects of present governmental or international opportunities to direct all private and public measures in the interest of a broad open opportunity of international trade is bound to raise the following question To what extent under present market conditions are multinational corporations possible instruments of restraint of international trade as a whole or of trade between particular nations or of trade within certain nations? Since by definition every multinational corporation has an international effect, mere reference to national legislation of the type of the British, Common Market, American or Japanese restriction cannot be very helpful; the problems are necessarily not only dealing with the character of open commerce but are unavoidably of a political character.

2 There seems to be no better way of looking at the actual problems of today, leading to the question of how a co-ordination of national policies or laws or an international policy may deal with the present situation, than to consider a number of group examples of special importance in modern industry.

In my lecture I am going to use two group examples with, however, the understanding that I am fully prepared to use other group examples.

Group 1: Multinational corporations may be seen as instruments of market regulation in industries de- [illegible] fuel. We find corporate entities integrated in the unit of the multinational corporation under the active or implied direction of the head company as

(a) the mining company;
(b) the transportation company;
(c) the refining company;

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(d) the company utilizing the refined raw material for the production of other products;
(e) the distribution company.

Group 2: Multinational corporations may be seen as instruments of market regulation based on research and technology; from the basic research to the final distribution of products, these corporations are integrated in the following way:

(a) the research company;
(b) 'patent holding' company controlling also know-how and trade symbols;
(c) the company producing goods based on this research;
(d) the company distributing the products from (c) as well as other companies for the purpose of distribution.

It is obvious that these two group examples cover so large a portion of the present international trade that it seems to be justified to use them for the particular purpose of this lecture. However, we should also keep the following additional groups in mind: the group of production, transportation and final distribution of consumer goods such as cars, as well as the new group of multinational corporations in the banking field, not only as a banking control but also as a general economic control.

3 The restrictive effects of measures undertaken by the multinational corporations of group examples (1) and (2) can be observed in the following points:
3.1 The market influence of one particular multinational corporation, such as in the field of aluminium or copper, may be strong enough to set conditions either on all levels from mining to final distribution or at least on the level of the principal utilization of the raw material. In these cases one multinational corporation is strong enough to determine how much, where, how and under what conditions production, distribution or services take place in this field. This naturally includes all possible interferences, either in the entire field or at least in the relationship between certain countries or in one particular country.

Much more often, however, the influence of one multinational corporation alone will not be sufficient to set the extensive or restrictive conditions of trade in one entire group or at least on some level. In all these cases we observe that the co-existence of multinational corporations with each other, or partly with each other and partly with certain national business entities, leads to some type of 'established market' within which automatically the co-ordinated regulation of the market, extensive and restrictive, may take place. In many cases the comprehension of oligopolistic markets is not too helpful any more. The decisive point is that all economic conditions such as quantities, production, distribution, prices or division of markets etc. developed into actual facts of rather permanent character which are not going to be changed by the participating enterprises. As a matter of fact, our steady aluminium or copper industry show that in almost all cases there is actual co-operation by the multinational corporations, as in the bauxite pools or in regulation of copper quantities in the 1956 crisis or the regulative measures in dealing with Soviet goods.

The existence of an established market is an important difference to actual pre-war cartel arrangements which existed in order to retain control of a market for a long time.
3.2 In the mining or research based group, the market influencing power depends especially on the strength of the position on the level on which mined products or research results are being utilized. The more recent development of all types of vertical integration, as in aluminium and copper but also paralleled in the research based fields, show the importance of this point. Nationalization of mines or similar governmental interferences as well as international agreements, such as the agreement of the oil or copper exporting countries, may be instruments of strengthening the market export power of the enterprises in control of the utilization of mine products or of research. This is due to the fact that no newcomer has access to the products developed under government licences or under research licences.
3.3 The continually increasing integration of markets referred to under 1, especially the development in technology, gives market control since in many cases products such as oil, fibre, fertilizer, plastics and many pharmaceuticals extend to many other markets.
3.4 While it is beyond any doubt that multinational corporation trade policies are important elements of continuous trade extensions, they exercise restrictive influences in determining the total quantity of certain products, e.g. copper restrictions in 1956, and the availability of aluminium in international markets today.
3.5 Markets are divided geographically as in the field of aluminium, with special reference to the Pechiney policy.
3.6 There may be discriminatory practices as to prices or to access to the most recent technology in the trade between nations.
3.7 Determination of certain national markets may be limited in production, import, export or methods of distribution.

This list of restrictive practices indicated in our group examples should be sufficient for the clarification of the problem, especially since one restriction implies the other, e.g. an agreement on high prices implies a regulation of quantity of production.

4 The actual potentiality of restrictive as well as of extensive practices has political effects in the following way. Since by definition the multinational corporation subjects corporate entities owing loyalty to country B, C and D to the command of a corporation owing loyalty to country A, and since furthermore the trade policies of a multinational corporation necessarily affect international trade as a whole as well as that of particular nations, a conflict with the interest of governments or of other business or consumer entities everywhere is a necessary possibility. For instance, between 1950 and the beginning of the sixties, there was a general common interest in a continuously extending productive capacity and market everywhere, and under a surprisingly stable monetary system the political implication referred to above was

not of urgent actuality. However, since at least 1965, governmental national interests, whether referred to as the balance of payment or the internal purchasing power of currencies or, an increased percentage of government orders preferring their own economy, brings up exactly what I am calling here political questions.

It may be sufficient to refer to a number of particular instances:

4.1 The head company, in its own interest or in the interest of the controlling company, distributes orders for mining products or products resulting from research only from their own country or country belonging to the same currency group or to countries with which, and for a particular reason, a favourable balance of payment appears to be necessary. As an effect of such rulings, one or several countries will lose orders which they would otherwise obtain. These countries may come into very serious situations of unemployment or political discrimination.

4.2 The prices for certain products are substantially lower in one country than those in neighbouring countries as a result of direction by multinational corporations. This situation has not only economical but also political effects between the countries. Of a very special and very important character is the implication of the United States presidential decree of 1 January 1968, which obliges American based multinational corporations to prevent reinvestment of profits or to decrease the investments from year to year, thereby weakening the economic and political power of the affected country.

4.3 Another example is the Federal Republic of Germany which is substantially dependent on the oil supply of a country like Libya as a result of the multinational corporation policy. The political conditions of the Federal Republic of Germany depend on political revolts in Libya. Other similar examples will be presented at the Conference.

[illegible] legislation as in the United Kingdom and the Common Market or in Japan or Switzerland are not very effective in overcoming the result of restrictive practices of multinational corporations as discussed under 2 to 4. Among the most important reasons the following have to be mentioned:

5.1 The prohibitions or limitations resulting from anti-trust practices are necessarily based on national law. Multinational corporations by definition, however, operate on an international basis. The application of national laws is only possible as far as the domestic trade or the immediate foreign trade interest of the countries having enacted the law is involved.

5.2 The application of the anti-trust principles requires extensive procedures on which administrative or judicial remedies can be based while the rulers of the multinational corporation may immediately adapt the policies and practices from case to case according to circumstances in their own interest. For them it is very often not at all difficult to paralyse the effect of such judicial or administrative rules.

5.3 The judicial or administrative remedies dealing

with organizations or practices of multinational corporations very often and very easily fall under the suspicion that they undertake to apply their own law extra territorially. As a matter of fact, the application of local anti-trust laws generally is nothing else in substance than the application of direct market regulation. The American regulation of oil trade by import quotas as well as limitations of production accomplishes an immediate reaction in the interest and practices of other oil producers, e g. Venezuela.

5.4 In discussing the United States anti-trust practice the lecture is based upon the evaluation of the relatively small effect of the anti-trust practice and of the attempt to overcome the restrictive practices of multinational corporations.

(b) The American pertinent legislation was enacted 1890 and basically amended 1914, 1916 and 1933 Already before 1933 the American courts have consistently developed the principle that acts of American enterprises in foreign countries can never be unlawful and subject to prohibition if undertaken in co-operation with foreign governments, e g. *American Banana* v. *United States Fruit Co.*, the case against the potash cartel composed of business entities owned by the French Government, and the Anglo-Persian oil case (the Anglo-Persian Co., predecessor of BP, was government owned).

In the present structure of the organization of national and international trade there are very many fields completely or largely regulated by foreign governments.

[illegible] part of an American based multinational corporation, it should be also true that the American courts withhold any interference if the American based multinational corporation acts through a subsidiary or otherwise in foreign markets in accordance with the foreign law permitting restrictive practices or even with the policy expressed by the foreign government. The United States Department of Justice participated [illegible] reaching restrictive practices of these American based multinational corporations and their subsidiaries in foreign markets, being a part of the American trade system. While the judgements expressed the illegality of these agreements they excluded the application of the law in cases of expressively positive government regulation as well as in the permissiveness of restrictive agreements under foreign law and in cases in which a wish or policy of foreign governments was in point. Especially interesting are the agreements of oil and copper exporting countries.

While the consent judgements do not set precedents in the case of common law, the impact of the industries involved suggests that at the present American based multinational corporations are out of reach of the American anti-trust law whenever they or their subsidiaries act in co-operation with a foreign [illegible] ment.

It is not as clear that foreign [illegible]

corporations may refer to government positive action or lawfulness if either their subsidiaries in the United States or the head company, through services of the subsidiary of the multinational corporation, is brought before the American court on account of foreign trade regulation. The Swiss watch case was not decided by a court. The case was settled with the understanding of the Swiss Government.

The present American insistence on voluntary agreement in textiles and steel seemed to indicate that the United States Government wished to refrain from any prohibition whenever consistent American interests and requests existed.

In regard to domestic action of American based multinational corporations, as in copper, an analysis of economic conditions would show that the effect of vertical integration and the maintenance of a relatively high price depends on the co-operation of American based multinational corporations in the American market. However, no attempt was made to do this.

Since the United States does not follow the principle that district attorneys or United States Attorneys are bound to bring law suits whenever they obtain sufficient knowledge that the law has been violated, it is more or less a political question if such cases are brought before court. This is of special importance in the domestic activities of foreign based multinational corporations.

6 The statement of the very peculiar problems of restrictive practices of multinational corporations makes it quite natural that the regular remedies, especially of a prohibitive character or of providing for dissolution of existing entities with a basic effect on the country in which the remedy is applied, are neither sufficient to protect the different national and international public or competitive interests nor the interests of the multinational corporations themselves in the maintenance of regular channels of trade within which the determination of the ruling group in one country is presumably also helpful and productive to other interests.

The chances of multinational corporations in the markets are now endangered since these markets are subject to the potential restrictive practices of other business entities or of different governments. There is no chance of co-ordinating these different effects of restrictions

My suggestions which I am going to present to the Conference, and which I shall work out in detail in consultation with people representing many different interests, will be stated in the following way:

(a) Protection of national markets, by enjoining certain practices and dissolving certain organizations within the border lines of a particular country, provided the law of the country involved permits or commands this protection.
(b) Positive government action (1) in the country of the controlling group of multinational corporations and (2) in the country of the controlled group of multinational corporations.
(c) Protection of international markets, (1) to a very limited effect in application of some national anti-trust legislations which cover certain international effects, and (2) especially by the OECD or GATT or other international groups covering only a number of states: to establish informal procedures to set aside certain restrictive practices and their effects.
(d) Postive support to counter-balance particular restraints in a number of countries or in one country by international organizations, for instance by the World Bank or similar regional government banks.
(e) Inquiries, methods and devices to guarantee access to information on the organizational practices of multinational corporations. The amendment and co-ordination of national laws on reporting on business organizations including corporations, for instance, the amendment of the German corporation statute on providing for publication or lack of publication on 'international' concerns. This practice is not too different from the present American SEC.
(f) National Boards of Inquiry or investigative committees similar to the United States committees of House and Senate.

It would be necessary to co-ordinate the practice of different inquiry boards in different countries to insure the greatest possible success.

The importance of business secrets should not be overemphasized.

International Boards of Inquiry, such as the boards of the OECD, should be established only if there is a good insurance that their reports are published. It is most advisable that, parallel to such reports, universities undertake studies in the same fields.

In my presentation I am going to suggest a number of amendments, especially to the American anti-trust legislation to guarantee that anti-trust is never used as a protecting power of multinational corporation rulers but as an efficient control of such powers.

4.4 Competition and the multinational firm: The United Kingdom case*

M D Steuer

The operations of multinational firms raise a serious question of monopoly power for host countries. The economics of inward direct investment cannot be based on the theory of perfectly competitive markets because the assumptions of this theory are violated by the size and market share of many foreign owned subsidiaries, and the implications of this theory are in important respects not consistent with the evidence. For example, under the assumptions of perfect competition, a country either receives or sends out direct investment capital, but not both. Capital migrates in order to take advantage of differing rates of return in different countries, and in equilibrium the flows exclusively into or out of a single country have the effect of equating returns everywhere. But for the United Kingdom, direct investment is characterized by 'cross-freighting', the in and out flows are simultaneously substantial. In his recent book, *American Business Abroad*, Professor Kindleberger states

the question of whether on balance the multinational firm widens or restricts competition is much more problematical.[2]

To form a judgement in this area it clearly is not enough simply to document the role of giant firms in total direct investment. While the present chapter will go some way towards doing this, the central point is that competition is not perfect in the absence of the foreign owned firm. American, European and other large foreign subsidiaries may be operating in British markets which would be even more monopolistic in their absence. An oversimplified dichotomy of more or less leaves out of account such questions as whether one is referring to product or factor markets, whether one is referring to the short or the long run, and other dimensions of the problem, which we will have to explore. Our present preliminary point is that the typically large scale of the multinational firm is consistent with both favourable and unfavourable effects on competition in the host country.

Professor Dunning's recent pamphlet, *The Role of American Investment in the British Economy*, affords a brief and up-to-date picture of the United States contribution to the inward stock and flow of foreign capital.[3] In it he discusses six problems, or potential drawbacks, of direct investment. These have to do with such issues as effects on technology here, conflicts between subsidiaries and national economic and political policies, tax avoidance, export restriction, and so on. Though he does not list monopoly power as a problem as such, this aspect is implied and involved in the other problems. Indeed, this is almost bound to be the case. Under perfect competition the other problems would not arise. Traditionally, economists place little emphasis on questions of ownership, who controls a particular productive unit. The theory of profit maximization calls for the same behaviour regardless of who is the owner, so it is of little interest. The monopolist behaves differently from the perfect competitor, but not because he is foreign rather than domestic. However, staying within the traditional framework, the profit maximizing foreign monopolist may behave differently in the host country compared to a domestic firm because being a unit in a multinational company alters the constraints. We will devote some attention to the traditional monopoly problems, higher price, smaller output, unexploited economies of scale, monopsonist buying behaviour, in the setting of the multinational constraints. It is particularly important to do so because the benefits of inward investment to the host country depend on not all the extra efficiency being captured by the foreigner.[4] Some must be competed away. But it is

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1 Kindleberger, Charles P, *American Business Abroad, Six Lectures on Direct Investment*, Yale University Press, 1969, pp. 31–2.
2 Professor Kindleberger's judgement is a favourable one. '. . . its main impact is in widening the area of competition'. Ibid., p. 32. Not surprisingly, journalists have tended towards the opposite conclusion, e.g. Francis Williams, *The American Invasion*, Anthony Blond, 1962; J MacMillan and B Harris, *The American Take-Over of Britain*, Leslie Frewin, 1968, J J Servan-Schreiber, *The American Challenge*, Hamish Hamilton, 1968.

3 Dunning, John H, *The Role of American Investment in the British Economy*, (with two case studies by W G Jensen), PEP, Broadsheet 507, February 1969.
4 Aspects of this proposition are discussed at several points in the Watkins Report. See in particular the section 'Diffusion of Net Benefits', *Foreign Ownership and the Structure of* *Ind* Report of the Task Force on the structure Privy Council Office, Ottawa, January

also important that we step outside the traditional framework. We will also devote attention to the neo-technology monopoly problems.

Generally, exporting is an alternative to investing abroad. Which is more profitable depends on tariffs, transport costs, taxes, factor costs, advantages of proximity and so on. In appraising the significance for competitiveness of direct investment, we must assume that the alternative, in most cases, is imports, and not that the product does not arrive at all. This leads us to direct special attention to the role of tariffs and the effects of monopoly on factor markets.

Professor Vernon, and others, emphasize the role of innovation and uncertainty in the explanation of direct investment.[5] An important part of the explanation of why firms invest abroad, why the firm becomes multinational, is related to monopoly. Large firms can support more extensive research programmes in America, and the benefits of the research can be applied from a commanding market position. If a new product succeeds, sales may begin abroad. As exports expand, the innovator feels sufficiently confident to undertake investment in sales, and perhaps light assembly, in foreign countries. As sales expand further, more and more production is undertaken abroad. Note that the shift to production abroad does not result from changed cost conditions. Indeed, if it was profitable to produce abroad in the end, so it was in the beginning. But was the market there, and what were the cost conditions? The role of uncertainty is a critical justification of this process of feeling one's way along. It also means that the direct investor begins in a position of some monopoly power at home and arrives in a monopolistic position abroad. Some investment more clearly seems to be of this kind. Considerable empirical investigation, so far largely favourable to the view, is in progress.[6] It suggests the importance to the direct investment phenomenon of a continually maintained monopoly position which is achieved in part by a continually advancing research and development programme.

There are other theories of direct investment which depart from the traditional arguments in terms of rates of return on capital. One is the view that managerial spare capacity is itself a key factor in firm growth. Growth of output is one dimension, along with growth of plant, number of employees, and similar indices of scope of control. Where the firm cannot expand at home because of market saturation or anti-monopoly legislation, expansion abroad is a possibility. Professor Penrose, for example, has emphasized this role of managerial capacity.[7] What should be clear by now is a fair presumption in the direction of the importance of monopoly power in the direct investment phenomenon.

Of course, even if the multinational firm is a monopolistic firm, it does not follow that such firms have an adverse effect on competitiveness in the host country, as we mention above. An incoming giant may add to the number of competitors, even bringing about some competition where there was little before. A policy of growth through acquisition may have the opposite effect. I agree completely with Professor Kindleberger that generalizations on the level of new establishment vs. take-over, manufacturing vs. distribution will not enable us to distinguish helpful from harmful direct investment. And also, 'Direct investment is, then, a subject in which it is necessary to judge case by case'.[8] But what, we might ask, are the criteria? Would reasonable men tend to agree that a particular investment proposal was good or bad for competitiveness in the host country? We hope to make some progress with these questions.

The choice of the United Kingdom as a case study, has certain interesting features. Direct investment and monopoly raises the spectre of United States domination. While other countries also are the home base for important international corporations, it is America in particular which arouses fear. Often United States firms are investing in sectors where the host country has no domestic inquiry. Then the question is either have the American or nothing at all. For the United Kingdom the situation is different. Substantial domestic activity exists in all sectors. The technical level of development and income per capita compared to the United States is closer than for most industrial host countries. From the point of view of concentration the two countries are similar in outline. 'The United Kingdom evidences a tendency toward approximately the same (as the United States) or a slightly lesser degree of concentration of control of industries by a few large firms.'[9] This view of Professor Bain is supported by a range of interesting comparative material across countries. It tends generally to suggest greater similarity of the United Kingdom and the United States than is true of the other countries examined. The drive of many countries towards greater industrialization and towards higher income per capita suggests that the current effects of direct investment on the British economy may apply more broadly to other countries over the coming years.

The importance of company size in direct investment

In this section we hope to document the role of large firms and industrial concentration in the growth of direct investment. The first question is which of the foreign firms are doing the direct investing. Do the largest firms in foreign countries tend to establish subsidiaries here? The answer to this question is yes. That is not to say that the medium size, and even smaller firms in some cases, are not also engaged in foreign direct investment. But the large firms definitely are. Professor Vernon notes that, 'The number of companies involved in the overseas movement has proliferated. International direct investment is no longer the special preserve of a small number of very

[5] Vernon, Raymond, 'International Investment and International Trade in the Product Cycle', *Quarterly Journal of Economics*, LXXX (May 1966), pp. 190–207.

[6] For a recent example see, Wells, Louis T, Jr. 'Test of a Product Cycle Model of International Trade: U.S. Exports of Consumer Durables', *Quarterly Journal of Economics*, LXXXIII (February 1969), pp. 152–62.

[7] Penrose, Edith T, 'Foreign Investment and the Growth of the Firm', *Economic Journal*, (June 1956), p. 66.

[8] Kindleberger, op. cit., p. 36.

[9] Bain, Joe S, *International Differences in Industrial Structure*, Comparative studies in Economics No. 6, Yale, 1966, p. 76.

large US enterprises.'[10] He goes on to note the difficulty, from the point of view of statistical sources, of tracing trends over time. Elsewhere he observes [illegible] but presumably it is framed from the point of view of the parent company.

Looked at from the United Kingdom point of view, the evidence that the largest United States companies dominate in foreign investment here is overwhelming. Of the 500 largest industrial corporations and the fifty largest merchandising firms, both ranked by sales, 302 have some overseas interest in this country.[12] This amounts to 59 per cent of the industrial firms and 12 per cent of the merchandising firms, as indicated in *Who Owns Whom*.[13] These figures, and others following, are intended to apply to the year 1967, and in spite of referring to a phenomena undergoing rapid change, should be broadly accurate for the present. Much economic activity is also undertaken here by the fifty largest American bank, transportation and life-insurance companies. These are omitted from this compilation because of the difficulty of obtaining relevant information on a basis comparable to the industrial and merchandising firms.

While 302 of the largest 550 United States merchandising and industrial firms have an interest in one or more United Kingdom located firms, not all of the 302 enjoy a parent-subsidiary relationship or have a controlling interest, though most of them do. A few simply have a portfolio interest, such as Hart, Schaffner and Marx holding some shares in the Austin Reed Group Ltd. In some cases a minority interest, even a small minority interest, may be accompanied with licensing and other technical arrangements which could involve control over some aspects of the British firm's activity. For example, United Glass Ltd has some technical arrangements with Owen-Illinois Inc. involving, among other things, a small amount of [illegible] yet it would be a mistake to think of the channels of control as a simple one way flow from the States to here. Links in an international complex exert their influence on the complex as well. Alternatively, subsidiaries of United States companies, such as F W Woolworth & Co. Ltd, may in turn have overseas sub-subsidiaries, such as that company's holdings in Barbados, Jamaica, Trinidad and Tobago and Rhodesia. In some instances this type of formal arrangement may involve direct control of the sub-subsidiary by the American parent, and in other cases the control may lie with the British firm. There are also simple parent-subsidiary links in which the subsidiary is left entirely alone and is virtually auto- [illegible] count that as a direct investment. Some American firms maintain a 'paper' company here simply to insure no one uses their name. Others maintain an importing office which only receives orders and does book-keeping. But when they engage substantial numbers of salesmen, and undertake warehousing and perhaps packaging, it begins to look like a direct investment. There is an element of judgement involved in deciding when the degree of merchandising and product modification constitutes a direct investment in the sense of significant economic activity undertaken abroad.

Bearing in mind all the problems of interpretation surrounding the concept of control and significant foreign activity, a more careful check of the largest 550 United States industrial and merchandising firms reveals that 263 have ownership interest in one or more British firms. This is made up of six merchandising and 257 industrial, which is 12 per cent and 51 per cent respectively. We will be looking at the larger European and other foreign non-American [illegible]

It is also the case that the British subsidiaries of the largest American firms are in turn large firms among our subsidiaries. Confidentiality of returns to the United Kingdom government precludes identifying these firms by name. However, 300 foreign interest companies, excluding oil, had profits of more than £100,000 or losses of more than £500,000 in the year 1966.[15] Of these 300 firms, 140 are owned by the largest American firms. This rough and indirect indication that 47 per cent of the largest British foreign owned subsidiaries are owned by one of the largest American firms is probably broadly correct. Apart from the mismatching of years and the inappropriateness and mismatching of size criteria, there also is the problem that most United States parent firms have more than one subsidiary here.[16] In

[10] Vernon, Raymond, 'Antitrust and International Business', *Harvard Business Review*, September–October, 1968, p. 82.
[11] Vernon, Raymond, 'Multinational Enterprise and National Sovereignty', *Harvard Business Review*, March–April, 1967, p. 156.
[12] *The Fortune Directory*, Time Inc., 15 June, 1968.
[13] *Who Owns Whom (UK Edition), A Directory of Parent, Associate and Subsidiary Companies*, O W Roskill & Co., London, 1968.

[14] Anything approaching a fuller discussion of control is beyond the scope of the present paper. For some discussion of the type [illegible] 19 July 1968, pp. i–xxxi.
[16] A frequency distribution according to number of subsidiaries of the large US parents can be seen as follows

No. of subsidiaries	*No. of parents*
1	75
2–3	81
4–7	56
8–15	2
15 plus	1

Source: *Fortune Directory*

also important that we step outside the traditional framework. We will also devote attention to the neotechnology monopoly problems.

Generally, exporting is an alternative to investing abroad. Which is more profitable depends on tariffs, transport costs, taxes, factor costs, advantages of proximity and so on. In appraising the significance for competitiveness of direct investment, we must assume that the alternative, in most cases, is imports, and not that the product does not arrive at all. This leads us to direct special attention to the role of tariffs and the effects of monopoly on factor markets.

Professor Vernon, and others, emphasize the role of innovation and uncertainty in the explanation of direct investment.[5] An important part of the explanation of why firms invest abroad, why the firm becomes multinational, is related to monopoly. Large firms can support more extensive research programmes in America, and the benefits of the research can be applied from a commanding market position. If a new product succeeds, sales may begin abroad. As exports expand, the innovator feels sufficiently confident to undertake investment in sales, and perhaps light assembly, in foreign countries. As sales expand further, more and more production is undertaken abroad. Note that the shift to production abroad does not result from changed cost conditions. Indeed, if it was profitable to produce abroad in the end, so it was in the beginning. But was the market there, and what were the cost conditions? The role of uncertainty is a critical justification of this process of feeling one's way along. It also means that the direct investor begins in a position of some monopoly power at home and arrives in a monopolistic position abroad. Some investment more clearly seems to be of this kind. Considerable empirical investigation, so far largely favourable to the view, is in progress.[6] It suggests the importance to the direct investment phenomenon of a continually maintained monopoly position which is achieved in part by a continually advancing research and development programme.

There are other theories of direct investment which depart from the traditional arguments in terms of rates of return on capital. One is the view that managerial spare capacity is itself a key factor in firm growth. Growth of output is one dimension, along with growth of plant, number of employees, and similar indices of scope of control. Where the firm cannot expand at home because of market saturation or anti-monopoly legislation, expansion abroad is a possibility. Professor Penrose, for example, has emphasized this role of managerial capacity.[7] What should be clear by now is a fair presumption in the direction of the importance of monopoly power in the direct investment phenomenon.

Of course, even if the multinational firm is a monopolistic firm, it does not follow that such firms have an adverse effect on competitiveness in the host country, as we mention above. An incoming giant may add to the number of competitors, even bringing about some competition where there was little before. A policy of growth through acquisition may have the opposite effect. I agree completely with Professor Kindleberger that generalizations on the level of new establishment vs. take-over, manufacturing vs. distribution will not enable us to distinguish helpful from harmful direct investment. And also, 'Direct investment is, then, a subject in which it is necessary to judge case by case'.[8] But what, we might ask, are the criteria? Would reasonable men tend to agree that a particular investment proposal was good or bad for competitiveness in the host country? We hope to make some progress with these questions.

The choice of the United Kingdom as a case study, has certain interesting features. Direct investment and monopoly raises the spectre of United States domination. While other countries also are the home base for important international corporations, it is America in particular which arouses fear. Often United States firms are investing in sectors where the host country has no domestic inquiry. Then the question is either have the American or nothing at all. For the United Kingdom the situation is different. Substantial domestic activity exists in all sectors. The technical level of development and income per capita compared to the United States is closer than for most industrial host countries. From the point of view of concentration the two countries are similar in outline. 'The United Kingdom evidences a tendency toward approximately the same (as the United States) or a slightly lesser degree of concentration of control of industries by a few large firms.'[9] This view of Professor Bain is supported by a range of interesting comparative material across countries. It tends generally to suggest greater similarity of the United Kingdom and the United States than is true of the other countries examined. The drive of many countries towards greater industrialization and towards higher income per capita suggests that the current effects of direct investment on the British economy may apply more broadly to other countries over the coming years.

The importance of company size in direct investment

In this section we hope to document the role of large firms and industrial concentration in the growth of direct investment. The first question is which of the foreign firms are doing the direct investing. Do the largest firms in foreign countries tend to establish subsidiaries here? The answer to this question is yes. That is not to say that the medium size, and even smaller firms in some cases, are not also engaged in foreign direct investment. But the large firms definitely are. Professor Vernon notes that, 'The number of companies involved in the overseas movement has proliferated. International direct investment is no longer the special preserve of a small number of very

5 Vernon, Raymond, 'International Investment and International Trade in the Product Cycle', *Quarterly Journal of Economics*, LXXX (May 1966), pp. 190–207.

6 For a recent example see, Wells, Louis T, Jr. 'Test of a Product Cycle Model of International Trade: U.S. Exports of Consumer Durables', *Quarterly Journal of Economics*, LXXXIII (February 1969), pp. 152–62.

7 Penrose, Edith T, 'Foreign Investment and the Growth of the Firm', *Economic Journal*, (June 1956), p. 66.

8 Kindleberger, op. cit., p. 36.

9 Bain, Joe S, *International Differences in Industrial Structure*, Comparative studies in Economics No. 6, Yale, 1966, p. 76.

large US enterprises.'[10] He goes on to note the difficulty, from the point of view of statistical sources, of tracing trends over time. Elsewhere he observes that, '... nearly half of *Fortune's* 500 largest US companies today have extensive overseas investments'.[11] The definition of 'extensive' is not given, but presumably it is framed from the point of view of the parent company.

Looked at from the United Kingdom point of view, the evidence that the largest United States companies [illegible] This amounts to 59 per cent of the industrial firms and 12 per cent of the merchandising firms, as indicated in *Who Owns Whom*.[13] These figures, and others following, are intended to apply to the year 1967, and in spite of referring to a phenomena undergoing rapid change, should be broadly accurate for the present. Much economic activity is also undertaken here by the fifty largest American bank, transportation and life-insurance companies. These are omitted from this compilation because of the difficulty of obtaining relevant information on a basis comparable to the industrial and merchandising firms.

While 302 of the largest 550 United States merchandising and industrial firms have an interest in one or more United Kingdom located firms, not all of the 302 enjoy a parent-subsidiary relationship or have a controlling interest, though most of them do. A few simply have a portfolio interest, such as Hart, Schaffner and Marx holding some shares in the Austin Reed Group Ltd. In some cases a minority interest, even a small minority interest, may be accompanied with licensing and other technical arrangements which could involve control over some aspects of the British firm's activity. For example, United Glass Ltd has some technical arrangements with Owen-Illinois Inc. involving, among other things, a small amount of exchange of personnel. The American firm has some portfolio interest, *but the British firm is not a subsidiary* or an example of foreign control. At the other extreme, Esso Petroleum Co. Ltd is a wholly owned subsidiary of The Standard Oil Co. (New Jersey), yet it would be a mistake to think of the channels of control as a simple one way flow from the States to here. Links in an international complex exert their influence on the complex as well. Alternatively, subsidiaries of United States companies, such as F W Woolworth & Co. Ltd, may in turn have overseas sub-subsidiaries, such as that company's holdings in [illegible] the control may lie with the British firm. There are also simple parent-subsidiary links in which the subsidiary is left entirely alone and is virtually autonomous, though this is less common today than in earlier periods. These examples are mentioned here for illustrative purposes in order to indicate the variety and complexity of questions of control.[14]

The most difficult problem in counting the number of large foreign firms with direct investment here is not the question of minority interest, but the question of whether they are actually engaged in production or services in this country. For example, airlines maintain ticket offices here, but one would not want to count that as a direct investment. Some American firms maintain a 'paper' company here simply to insure no one uses their name. Others maintain an importing office which only receives orders and does book-keeping. But when they engage substantial numbers of salesmen, and undertake warehousing and perhaps packaging, it begins to look like a direct investment. There is an element of judgement involved in deciding when the degree of merchandising and product modification constitutes a direct investment in the sense of significant economic activity undertaken abroad.

Bearing in mind all the problems of interpretation surrounding the concept of control and significant foreign activity, a more careful check of the largest 550 United States industrial and merchandising firms reveals that 263 have ownership interest in one or more British firms. This is made up of six merchandising and 257 industrial, which is 12 per cent and 51 per cent respectively. We will be looking at the larger European and other foreign non-American firms, but for the present it is clear that a very significant number of United States giant corporations engage in direct investment in this country.

It is also the case that the British subsidiaries of the largest American firms are in turn large firms among our subsidiaries. Confidentiality of returns to the United Kingdom government precludes identifying these firms by name. However, 300 foreign interest companies, excluding oil, had profits of more than £100,000 or losses of more than £500,000 in the year 1966.[15] Of these 300 firms, 140 are owned by the largest American firms. This rough and indirect indication that 47 per cent of the largest British foreign owned subsidiaries are owned by one of the largest American firms is probably broadly correct. Apart from the mismatching of years and the inappropriateness and mismatching of size criteria, there also is the problem that most United States parent firms have more than one subsidiary here.[16] In

[10] Vernon, Raymond, 'Antitrust and International Business', *Harvard Business Review*, September–October, 1968, p. 82.

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[12] *The Fortune Directory*, Time Inc., 15 June, 1968.

[13] *Who Owns Whom (U K Edition), A Directory of Parent, Associate and Subsidiary Companies*, O W Roskill & Co., London, 1968.

[14] Anything approaching a fuller discussion of control is beyond the scope of the present paper. For some discussion of the issue see, for example, Brash, D T, *American Investment in Australian Industry*, Australian National University Press, 1966 and Safarian, A E, *Foreign Ownership of Canadian Industry*, McGraw-Hill, 1966.

[15] Figures based on the Board of Trade Annual Inquiry into Inward Investment. *Board of Trade Journal*, Vol. 195, No. 3721, 19 July 1968, pp. i–xxiii.

[16] A frequency distribution according to number of subsidiaries of the large US parents can be seen as follows

No. of subsidiaries	*No. of parents*
1	73
2–3	81
4–7	56
8–15	27
16 plus	18

Source Fortune Directory and Who Owns Whom

some cases one of the subsidaries is a holding company for all the others, reducing the problem, but not in all cases. So the total size of all the subsidiaries of a single American parent might place that group, as a group, among the largest foreign owned British subsidiaries, while no one of them qualifies on its own. In spite of these considerations, it is still a well supported generalization that the British subsidiaries of the largest American parents are generally large firms compared to other foreign subsidiaries here.

Probably more interesting is to compare these American owned subsidiaries to British firms generally. Here we find that 45 of them are among the 500 largest United Kingdom firms.[17] The accounting year varies company by company, but the ranking, by tangible assets less current liabilities and sundry provisions, centres on the year 1967. *The Times* list includes merchandising along with industrial companies. A frequency distribution can be expressed as follows:

Table I

Company rank in United Kingdom	*No. of subsidiaries with large* *US parent*	*Non-US parent*	*Total*
1–100	8	3	11
101–200	8	3	11
201–300	13	4	17
301–400	7	3	10
401–500	9	0	9
Total	45	13	58

Source: The Fortune Directory and *The Times 500*, op. cit.

The spread of numbers of subsidiaries is quite even, with some clustering in the 201–300 range. Of course there are other non-American foreign owned firms among the largest British 500. They also are evenly distributed, but not represented in the lowest, 401–500, range.

With respect to the non-American large firms, there is a problem of coverage. One could, in principle, cull over the largest firms in each country, as we have done with the States. That would imply a relative approach, treating the largest in every country as comparable. It would give an answer to a slightly different question than the present one: do the larger firms in other countries invest here, larger defined in terms of relative size in each country. Our present interest is in the larger firms abroad taking the world as the unit. For this purpose we have again used *Fortune* magazine for, 'The 200 Largest Industrials Outside the US'.[18]

Of these 200, fifty-three are British firms. With the remainder we find a significant proportion, as with the Americans, thirty-eight out of 147, have subsidiaries here. Of these, nineteen are among the largest 300 United Kingdom based foreign owned companies, and thirteen are among the largest 500 United Kingdom companies.[19]

This section, of necessity, presents a great deal of somewhat tedious and hard to digest material. The following table summarizes the main results. It is broken down for United States, non-United States, the total, and excluding oil. It should be emphasized that the topic at the moment is not how important is foreign direct investment in the United Kingdom, but how important are larger firms, and firms owned by large firms, in that investment.

There is some reason to regard the table as conservative with respect to the point it is making. For one thing, some of the largest non-American located firms are themselves American owned, reducing the relevant sample. Errors will result in overlooking large foreign interests. Foreign influence may be diffuse, i.e. several individual subsidiaries may add up to a large UK interest, and foreign influence may be disguised. Nevertheless, the role of bigness emerges clearly. We must now turn to the significance of direct investment in particular United Kingdom industries.

Concentration and foreign direction investment

We have considered the role of large firms, and firms owned by large firms, in inward direct investment. The next step is to attempt an assessment of the impact, or the significance of, the foreign owned firm in individual sectors. Is this investment more or less

Table II

	United States		*Non-United States*		*Total*		
	Excluding oil	*Including oil*	*Excluding oil*	*Including oil*	*Excluding oil*	*Including oil*	
1 Large foreign firms, number of, i.e. our sample	522	550	134	147	656	697	(1)
2 Number among (1) with one or more subsidiaries here	244	263	34	38	278	301	(2)
3 Ratio of (2) to (1)	46·7	47·8	25·4	25·9	42·4	43·2	(3)
4 Number of (2) among 300 largest UK located foreign owned subsidiaries (excluding oil)	140	—	19	—	159	—	(4)
5 Ratio of (4) to (2)	57·3	—	55·9	—	57·1	—	(5)
6 Number of (2) whose subsidiaries are among largest 500 UK companies	40	44	11	13	51	57	(6)
7 Ratio of (6) to (2)	16·4	16·7	32·4	34·2	18·3	18·9	(7)

Source: See pages 214 to 215 above. Figures refer, where possible to 1967.

17 *The Times 500, Leading Companies in Britain and Overseas, 1968–69*, Times Newspapers Ltd., London, October, 1968.

18 *Fortune*, 15 September, 1968, pp. 130–6.

19 The method and sources for these figures is exactly as was described for the United States contribution, drawing now on the *Continental Who Owns Whom*.

evenly distributed across the economy? Does it figure predominantly in particular sectors? And what is its role in the especially concentrated British sectors? In this section we shall try to illuminate these questions, insofar as our data will allow it.

Basing our information largely on the 1963 Census,[20] and abstracting from those manufacturing industries for which information is not available, we find that foreign owned firms accounted for 10·2 per cent of employment, 12·6 per cent of sales and 18·2 per cent of capital expenditure. (The industries covered employed 7·9 million workers.) Using the employment criteria to measure proportion of foreign involvement, we have a high of 41·7 per cent in pharmaceutical and toilet preparations and a low of 0·2 per cent in tobacco. A frequency distribution can be drawn as follows.

Table III

Number of industries, out of twenty-seven, where foreign proportion is of indicated amounts, according to three criteria

Per cent	*Employment*	*Sales*	*Capital expenditure*
0 to 2·0	6	5	5
2·0 to 7·0	5	6	5
7·0 to 15·0	4	5	6
15·0 to 25·0	7	5	5
25·0 to 35·0	3	4	2
35·0 plus	2	2	4

The sectors in which, on either sales or employment criteria, over a quarter of the activity is foreign are: (capital expenditure for one year can vary too much to use this criteria.)

Table IV

Industries with large foreign components

	Emp. 000's	*Sales 000,000's*
Pharmaceutical and toilet preparations	28 6	130·2
Dyestuffs, fertilizers and other chem.	62 7	362 3
Explosives, soap, polishes	42·9	255 8
Motor vehicles and cycles	133 8	777 4
Scientific instruments, watches	38 0	92 4
Rubber	27 2	106·7
Total	333 2	1,724 8

These sectors account for 41 per cent of the employment of the group, and 54 per cent of the sales. So it is fair to say that a very substantial proportion of foreign direct investment is in sectors where that component collectively plays a significant role.

It is interesting to comment on the degree of concentration in these six industries. We have figures, again specially provided by the 1963 Census for 1958 and 1963, on the proportion of sales accruing to the top five firms in each of 277 manufacturing sectors. These are at three digit sic classification or more, i e. much more detailed than the groupings above.

industry. These are rough indications that where inward investment is larger in proportion, the degree of concentration is greater than average.

Turning now to this more detailed data on 277 manufacturing sectors, we can examine, in various ways, the degree of association between proportion of foreign activity and concentration, the former measured in proportion of total sales accounted for by foreign owned firms and the latter measured in terms of the proportion of total sales in the sector accounted for by the five largest producers. The foreign participation is broken down in the data for the United States subsidiaries and the total.

determination is 0 08 and the slope coefficient is highly significant, an f value of 25 2 Looking at the total foreign contribution, including the United States component, raises the r^2 to 0·13 and the f value to 44·3. It is fair to conclude that there is some association between the extent to which a sector has foreign activity and its degree of concentration As there are a large number of sectors with no foreign component, American or otherwise, but varying degrees of concentration, we could not expect a strong correlation

A more appropriate test of the proposition that foreignness and concentration tend to go together is a

		Concentrated More	Less
Foreign (all sources)	More	68	22
	Less	72	115

number of larger amounts and smaller amounts of foreign participation. But in less concentrated sectors there are few which have large foreign participation

Taking just the United States component of foreig business here, a similar picture emerges.

		Concentrated More	Less
Foreign (US only)	More	59	30
	Less	81	107

Again, the critical feature is the absence of American owned firms in the less concentrated sectors overall pattern is a bit less pronounced c taking all foreign sales. But $\chi^2 = 13$ for t

[20] As is well known, compilation of this census of manufacturing has run into extraordinary difficulties. The figures quoted here were provided on request of the Board of Trade, Economic Services Division, through Mr Barrie Scott, then in the Division. We are most grateful for the help of the Business Statistics Office.

States only, is still highly significant, beyond the one per cent level.

Firm size and concentration are related, given the industrial breakdown. If the foreign subsidiaries were to be sufficiently large, the presence of one of them in a sector would be sufficient to make that a concentrated sector. However, this is typically not the case. Taking thirty-two cases of high concentration and high United States investment, in only two sectors is a single United States firm responsible for that sector having a heavy American component. (And in one of these sectors there are other foreign firms.) In eight cases there are two Americans, and in over two thirds of such concentrated sectors there are three or more United States subsidiaries operative. Where a sector is concentrated and has a large foreign component, usually several foreigners, not one, are contributing to that component.

The next table gives a frequency distribution of numbers of foreign firms operating in each of our 277 manufacturing industry categories. Quite a number of sectors, thirty-nine, have no foreign firms, and some have a great many. But most sectors have a few. Only 8 per cent have more than ten, 44 per cent have three to ten, 33 per cent have one or two, and in 14 per cent of the sectors there are no foreign firms. Though there are sectors with one or two foreigners, over half the sectors which do have foreign firms have between three and ten of them.

It is interesting to compare this distribution with that of the sectors which are above the mean in terms of concentration. There are 140 such sectors and the proportion with various numbers of foreign firms can be compared below.

Table V

Distribution of foreign firms across all sectors, and across the more concentrated sectors

No. of foreign firms	*All sectors*	*Proportion of: more concentrated sectors*
0	0·14	0·14
1 to 2	0·33	0·33
3 to 10	0·44	0·49
Over 10	0·08	0·03

While there is a slight tendency for the proportion in the three to ten foreigners range to rise in the more concentrated sectors, the two are remarkably similar. Of the total of 1,224 foreign firms in the group, 486 are in the more concentrated sectors. And the distribution across the more concentrated sectors is, for all practical purposes, the same as the distribution across all sectors. Lest this appear to contradict the finding above that foreignness is associated with concentration, it should be emphasized that foreignness is measured by proportion of sales of foreign to domestic firms, not by number of foreign firms. When we count heads, we are as likely to find a few foreign firms in an unconcentrated industry as a concentrated one. But if we know that an industry is unconcentrated, then the odds are roughly five to one, that the proportion of foreign sales is less than average in that sector.

While it is of some value to establish the role of large subsidiaries, and subsidiaries owned by large firms abroad, and to relate these incoming firms to the state of concentration in British industry, this leaves the question of causality untouched. What would concentration in the United Kingdom look like had the inward investing firms not come here? How much of their establishment and growth is by take-over *and* reduction of the number of meaningful competitors, and how much adds to the competitiveness of industry? To answer these questions involves three difficult problems. Concentration is a problematical index of monopoly power. Imports may keep competition keen in spite of few producers in the country. And, it is not easy to say when a competitor is 'meaningful'. These are intriguing questions which we cannot explore here. However, we can get an interesting glimpse into the inward investment effect on monopoly power, if only a glimpse, by examining changes in concentration.

For 218 of the 277 sectors we have been examining we have concentration ratios for 1958 as well as 1963. Change in concentration over the five years can be measured in a variety of ways. We chose the absolute change, C_{63}–C_{58}, treating an increase of 5 per cent from 15 per cent to 20 per cent as the same as moving from 85 per cent to 90 per cent. The median change in concentration was an increase of 2·77 per cent. Using the median foreign proportion of sales of 15·1 per cent for the reduced sample of 218 sectors, a four way classification falls out as follows:

		Change in concentration More	Less
Foreign (All sources)	More	24	45
	Less	87	62

For these sectors for which we have figures for concentration for two years, as for all the 277 sectors, the larger groups of sectors have less than average foreign investment because of the skewness of the distribution of proportions, and the consequent few sectors contributing to the high level of the mean. And among these sectors with less foreign sales, they are about as likely, roughly, to have increased in concentration more than average as less than average. But where there are more foreign sales, there is a markedly greater tendency for concentration to have decreased compared to the average change in concentration. Of course, it would be better to have figures for change in foreign proportion to relate to change in concentration. But these are not available. All we can say is that there is a negative association between more foreign sales, as a proportion, in 1963 and the change in concentration from 1958 to 1963. The χ^2 on this relation is 10·5, the lowest of the three reported, but still, like the others, significant at the one tenth of one per cent level. If we are looking at a sector with more than average foreign investment, odds are, two to one, that we are looking at a sector where concentration has declined, 1958 to 1963, compared to the average.

From the above we certainly cannot jump to the conclusion that inward investment increases competi-

tion. It is worth noting that the 1,224 foreign firms making up our sample are owned by 579 companies abroad, 434 in the United States, *many of the foreign interests operating an enterprise in more than one* United Kingdom sector. All the data we have examined supports the generalization that foreign investment here is done, to a significant extent, by large firms abroad, their subsidiaries are often large *compared to domestic firms, and they tend to appear* in the more concentrated sectors, though in sectors where concentration is decreasing compared to recent average changes. It is now time to ask, so what?

Monopoly power and host country gains from direct investment

When foreign owned establishments are located in regions of this country where economic activity is depressed and the level of unemployment is high, the gain to the United Kingdom economy can be very great because some factors, particularly labour, are employed which otherwise would be unemployed. Some American investment in Scotland, such as the Joy Manufacturing and Kaysers, all located in Greenock, is of this kind. While it is true that a proper appraisal of foreign direct investment should assume a successful full employment policy with and without the direct investment, the possibility of directing foreign firms to depressed regions, who may prefer them in any case, brings about an exception to the general rule. The kinds of misallocation of resources, and other distortions due to monopoly, take on importance in depressed regions. The regional aspect of direct investment raises many other issues which we [illegible]

[illegible]

Besides the monopoly and efficiency (tariff) point, the 'second' point referred to above has to do with the tax on profits of foreign owned firms.

> The second key point to emerge from the discussion is that the nature and extent of the benefits from direct investment depend on the ability of (host) governments to tax profit accruing to foreigners at an optimal rate.[14]

These views on competition, tariffs, and profit tax were expressed in the context of the Canadian economy, and I have reviewed them in that setting. But reading them as general statements, we may question the first, and amplify the second and third in the United Kingdom context.

[illegible]

be very unlikely to engage in the textbook manoeuvres of holding down prices in the hope of putting on the bite when the field is clear. But the main point is that we should direct attention to whether the incoming firms improve competition over what it *would have been*, not whether they have some monopoly position.

Carrying on, the position of a foreign large firm is not like that of a domestic large firm. Two things in particular, its financing possibilities, and its power relations in the labour market, are not the same. The ability to shift some, or all, of its operations to another country gives it a threat the domestic firm lacks. Naturally, this is not a threat than can easily or costlessly be made good. It deserves attention, especially in the light of the frequent observation that the industrial relations of the incoming firm often differ, or attempt to differ, from traditional British practice. Managers, particularly of American foreign owned firms, express the view that they achieve higher productivity and profitability than their British counterparts through more careful labour utilization, rather than through technological advantages or a higher capital input. Of course, this is an explanation flattering to management itself and one probably should be cautious in accepting it without investigation.[25] But it makes the issue of the monopolist exerting pressure in the factor markets, and critically the labour market, all the more intriguing. While it is the case that the foreign owned firm has a reputation for paying high wages, and in particular cases investigated have been shown to do so, they go for higher quality labour. As purchasers of labour services they may enjoy monopsonist gains, regardless of their hourly rate structures.

This leads to the second consideration, which turns on direct investment as an alternative to exporting. Like the first point, it suggests a more relevant basis for comparison. A foreign product may be in a monopolistic position whether it is produced abroad and imported, or produced here. If direct investment does not alter the product, it should leave the demand curve for it unaffected. Assuming there are no tariffs, the cost curve for production abroad presumably would lie below the old cost curve. This would result in a lower price and a larger consumer surplus. So there is a somewhat simple case for the conclusion that direct investment is preferable to importing a monopolistic product on the consumption side. (A tariff can help remove some of the advantage of monopoly from the production point of view, but direct investment across a tariff wall carries with it no presumption of a lower cost curve.) However, there is an analogy to customs union theory here, with a possibility of an adverse production effect and a favourable consumption effect. Domestic inputs into the foreign owned subsidiary will be subject to some misallocation due to the firm's monopoly power. On balance, the move from importing to production here of a monopolistic product will typically entail two contradictory effects which on balance need not adversely effect welfare even though the proportion of domestic factors engaged in less competitive industry has risen.

The third mitigating point has to do with the role of product innovation in establishing a monopoly position. After discussing in a general way the welfare problems of private production of knowledge, H G Johnson makes a number of applications to the direct investment case, and also observes the following. 'High measured rates of profit on capital, often taken as an indication of "exploitation", may not in fact be so, since the "excess" profits may represent a return on past investments in creating capital in the form of knowledge which does not appear on the firm's books as an addition to material capital'.[26] No one would say this is the whole story. The question of whether foreign investment in, and advances in, technology are helpful or harmful to this country is a large and difficult one. But insofar as profits of large firms are derived from payments for research, they are not a true cost of monopoly.

Finally, before going on to the other two topics raised by the Watkins Report, it is relevant to pose the question of the cost of monopoly as a general one. If this cost turns out to be very small, then there is a strong presumption that the monopoly element in direct investment is not such a serious factor. The whole question of whether imperfections in competition matter a great deal or hardly at all has been around so long and discussed so much that one blushes to raise it without having something interesting to add.[27] However, one must note the ambiguity surrounding the topic, and be careful in condemning direct investment because of its undoubted monopoly element. Attempts to quantify the cost of monopoly, such as those of Harberger and Schwartzman for the United States find very small costs indeed.[28] So along with legitimate research and development costs, direct investment as an alternative to exporting, and the lack of perfect competition without direct inward investment, we incline to the view that it is easy to overstate the welfare loss.

Let us turn now to the tariff point as raised by the Watkins Report. Numerous studies of direct investment rightly refer to tariffs, some finding in them a major incentive to direct investment. Johnson in the paper quoted, and of course Watkins above, emphasize the importance of traditional international competition in product markets as protection against the abuse of monopoly positions. Any study of concentration is not complete without taking trade into account. One firm may sell all of a given product that is produced in a country, but if imports enter

25 The industrial relations and labour utilization aspects of inward investment are currently being studied by John Gennard and the present author.

26 Johnson, H G, *The efficiency and Welfare Implications of the International Corporation*, A paper prepared for the Sloan School of Management, MIT, Spring 1969, Seminar on the International Corporation (mimeo), p. 6. Much of that essay is relevant to the current paper.

27 A convenient source for an overview of the literature is Hunter, Alex (ed.), *Monopoly and Competition*, Penguin Modern Economics, Middlesex, 1969.

28 Harberger, Arnold C, 'Monopoly and Resource Allocation', *American Economic Review (Proceedings)*, May 1954, pp. 77–87. Schwartzman, David, 'The Burden of Monopoly', *Journal of Political Economy*, December 1960, pp. 627–30, and, 'The Effect of Monopoly: a correction', *Journal of Political Economy*, October 1961, p. 494.

freely there may be no monopoly threat. In their present form our figures do not allow us to relate trade and concentration for the United Kingdom. However, it is possible to gain some impression of the extent of the protection from international

[illegible]

rather than nominal tariff rates.[29] Tariffs raise the price of the product and afford varying degrees of protection, with a given nominal rate, according to the relative importance of purchased inputs as against value added. The smaller the value added, the greater the effective protection afforded by a given nominal rate. (This must be qualified by taking into account the tariffs on the inputs. A firm where value added is half of price, operating behind a ten per cent tariff wall, but using an input subject to a twenty per cent tariff, is operating at world levels of efficiency, as if neither tariff existed.) Bela Balassa has calculated effective rates of protection for thirty-six British industries.[30] The industrial categories used are the BTN headings (Comparative Tariffs and Trade), and these cannot be matched perfectly with the Standard Industrial Classification in which our foreign interest figures are arranged. However, for twenty-two sectors it is feasible to make a comparison without great fear of statistical mismatching. In this sample there is virtually no relationship between the effective protection afforded by the United Kingdom tariffs and the extent of foreign investment in the sector. In fact there is a slight inverse rank correlation, $\rho = -0.2$, but this is not significant. The lack of a positive relation in this simple correlation indicates only what is well known, namely that many factors besides tariffs bear on the foreign investment decision. However, while there is no systematic relation, what is import-

[illegible]

figures are available, in seven the foreign component is greater than 50 per cent, measured in sales. These appear below along with their effective rates of protection.

Industry	*Foreign proportion*	*Effective protection*
Automobiles	52·1	41·4
Agricultural machinery	34·2	21·3
Precision instruments	32·5	44·2
Rubber goods	28·1	43·9
Non-ferrous metals	21·3	15·4
Non-electrical machinery	18·2	21·2
Metal casting	10·6	26·9

This is a highly aggregated listing, and arbitrarily selective due to the vagaries of data availability. But it indicates clearly that many foreign firms (and domestic ones) are encouraged to operate at levels of efficiency which compare adversely with world levels. The point is greatly complicated by the fact that these industries need not be, and in some cases definitely are not, competitive outside the United Kingdom. However, concern with monopoly gains on the part of foreign subsidiaries here should, on the basis of these figures, direct our attention, among other things, to the possibility of an inappropriate British tariff structure.

Coming to the final point of this section, we may comment on the Watkins proposition that host governments should, '. . . tax profits accruing to foreigners at an optimal rate'.[31] This advice raises a number of issues, among them the feasibility of a differential profit tax. If the 'optimal' rate for foreign owned firms turned out to be lower than the rate (traditional or optimal) for domestic firms, one might anticipate some grumbling. Such an arrangement would be unacceptable. So a differential rate would have to be the other way around, a higher tax for foreigners. Presumably, where ownership was less than one hundred per cent foreign, this would be pro rated. Immediately several problems suggest themselves. a sense of inequity in contrast to the present legal atmosphere where a foreign subsidiary is treated in every way like a domestic firm; retaliation on the very substantial volume of British investment abroad, a powerful incentive to generate profits in other countries through appropriate intra-firm pricing. The first two points are self evident. A word or two more might be appropriate as to the third.

All other things being equal, a multinational firm can vary the profits of its United Kingdom located subsidiary by varying the price of inputs sold to it from other parts of the multinational network, varying charges for research and development and other services, and varying the price paid for the output of the United Kingdom located unit by parts of the network located outside this country. Of course tax law here forbids artificially lowering profits in this way, and if an item sold crosses an ad valorem tariff barrier, customs officials in other countries will object to artificially lowering export [illegible] certainly costly. The firm's incentive to devote resources to profit manipulation will vary directly with the spread between rates here and elsewhere, restricting the scope for a separate rate for foreign owned firms.

Two points can be added, the question of what is the optimum rate, and whether a single national rate could be significantly altered in the light of a desired bite on the profits of foreign owned firms. The first is a difficult problem if one assumes no foreign response in terms of volume of direct investment, and much more so if one realistically takes into account of the response. With foreign investment the order of ten per cent, and these difficulties [illegible] an optimal rate, it certainly [illegible] [illegible] [illegible] a single [illegible]

[29] Not only is the empirical aspect of effective protection a matter of current concern, but the underlying theory as well. Without entering this controversy here, we use effective rates as being preferable to nominal rates, the latter being an even poorer index of protection.

[30] Balassa, Bela, 'Tariff Protection in Industrial Countries: An Evaluation', *Journal of Political Economy*, vol. LXXIII [illegible], pp. 573–94.

[31] Watkins Report, op. cit., p. [illegible]

that object in mind. These considerations, plus the problems mentioned of a differential rate, suggest that the advice to set an optimal rate of profit tax on foreign owned firms is a bit empty.

Conclusions

To recapitulate, we have attempted to document the role of large firms, and particularly firms owned by large firms, in the phenomena of direct investment in the United Kingdom. We conclude that bigness and a monopoly element are characteristic of inward investment. The evidence suggests that foreign investment comes mainly from industries which are concentrated and oligopolistic in the home country, and have these same characteristics in the host country. There is slight evidence that industries which have more foreign investment are becoming slightly less concentrated compared with the average change (increase) in concentration.

Next we examined the effect of the monopoly element on the diffusion of benefits to the United Kingdom from inward investment. In contrast to some examinations of this problem which have been done for other countries, we found less reason to be particularly concerned about the loss of benefit to us due to the monopoly factor. Using fairly general a priori argument we conclude that the welfare loss is likely to be small.

Apart from the way the monopoly power of the foreign owned subsidiaries influences the benefit to this economy of their presence here, we may say a few words on the effect of this investment on the competitive structure of this economy generally. Most of what might be said follows from the previously discussed material. With total foreign investment of the order of ten per cent, and the characteristic distribution of investment being as it is, it would be difficult to maintain that there has been a serious distortion of the economy from this source. But what if the investment continues to grow? The very latest trends indicate a tapering off, though we still may ask the question. The most important part of the answer rests on one's view of the reasons for the astounding success of the multinational firm. Is it due to size begetting size in a process of self-perpetuating power, or is it due to genuine economies of scale? If the latter, these are not the traditional scale returns in combining labour and capital, but rather scale returns to management, marketing and research and development.

Particularly the returns to research must be emphasized. In order for the profit maximizing firm to undertake the necessary outlay it must be possible for it to reap the returns to new knowledge. In this sense the scale features represent genuine economic efficiency. It is interesting to note that those foreign owned firms subject to Monopolies Commission and Restrictive Practices Reports, such as Champion Sparking Plug, Kodak, Mullard, Amalgamated Dental and the tyre companies (Goodyear, Firestone, North British Rubber, Michelin and Pirelli) have involved predominantly questions of technology. Nor have the investigations involved outcomes particularly harmful to the firms themselves. For the purposes of analysis, perfect competition has the advantage of powerful generalization on the basis of limited factual information. This is much less true of monopoly, and is clearly not true of oligopoly. We come back to the easy to give, and hard to follow, advice of the need to examine specific cases. In the author's view, these cases should not be thought of in terms of disturbances in a traditionally competitive setting. Rather, the issue is the degree of participation in, or resistance to, a growing form of economic organization. Selective participation, on the inward side, in the sense of allowing certain firms and excluding others, either because of the nature of the firms themselves or the industry to which they are heading, leads to an essentially illusory and make work policy. The real and hard choice, is how much to engage generally in the multi-national phase of capitalist economic development.

4.5 Practical aspects of differing attitudes to anti-trust

J Copp

A complex set of rules, growing in complexity, if it is not to get out of hand, needs a constant watch on the basic purpose which it is designed to achieve. It must not stifle, nor hinder unnecessarily, those who are governed by the rules, nor must it allow evasion or fail to cover activities desired to be forbidden. It must be comprehensive, clear in its meaning and certain in its enforceability.

How far does anti-trust fulfil this specification? To answer this question one must first observe that the rules of each country (insofar as it has them) differ from those of each other country, and that there has as yet been no real progress towards any harmonization. The EEC, it is true, has started to tackle this problem by producing its own rules which apply to each country in it in addition to that country's own rules. In time no doubt the various national rules of the member countries will wither away or be harmonized with the rules of the Community. A similar pattern may develop elsewhere.

Not only do the substantive rules in each country differ from those in each other country, but the attitudes to anti-trust and its enforcement differ also.

Multiplicity of differing laws and their complexity and obscurity, collectively and individually, must operate as a restraint on the activities of an international firm and, in theory at any rate, it would be well if they could be harmonized and simplified.

The purpose of this paper is firstly to consider the chances of harmonization, and secondly to consider, as an international firm has to consider, the practical *results of the differing attitudes to anti-trust* of the structure that has been built in each country as a result of those attitudes and the interrelationship of those structures on business activities.

We have already looked at the nature of the international firm and so I do not propose to comment in this paper on its identity. It is, however, clear that such firms are much more prevalent than they used to be and this trend will continue. Although by reason of its size and diverse locations it may have a greater manoeuvrability than firms with more restricted operations, it is, like them, subject to the anti-trust laws of each country in which it operates—it merely has greater problems because of the multiplicity of laws with which it has to conform and has to face such conflicts as there may be between them. It would be wrong, however, to think that there is any difference, other than degree, between an international and a large national firm.

We use the term 'anti-trust laws' as a convenient way of referring to the rules which relate to business [illegible] producer and customer, but as the result of the growing internationalism of business they are now used additionally to regulate each country's competitive position in the world. One can discern that they cover:

(a) acts which are in themselves thought to be wrong,
(b) acts which are in themselves wrong unless the doer of the act can show a justification;
(c) acts which are not in themselves wrong but may be or become so if they have objectively some undesirable effect;
(d) acts which are not in themselves wrong but may be condemned if subjectively it is thought that they may have undesirable effects;
(e) acts which adversely affect or may possibly adversely affect the economy of the country concerned.

Of these, the first two seem to be quite naturally the subject of law—they relate to acts which the country considers should be forbidden and they are, or should be, capable of precise definition. The last *three of these categories seem to me to be unsuitable* for judicial procedures and to fall properly into the sphere of administration—the acts themselves are not unethical, and the facts or assumptions which make them forbidden are not capable of precise definition, and indeed the application of the facts or the creation of the assumption will vary as the economic climate or the state of political thought in the country varies. But I'd like to come back to that thought after a little more consideration of attitudes.

Each country is both consumer and producer. As a consumer, a country may well be better off by being supplied by an international firm operating outside its boundaries, but as a producer it will naturally wish to have industry both operating within its own boundaries to provide employment, and [illegible]n national wealth by exporting to, or [illegible] other countries. If such an industry

Mr John Copp is from Imperial Chemical Industries Ltd.

th into a country it will need to have the strength
mpete. I should interpolate that *strength is not*
sarily equated with size: a firm will find it
ble to compete, even if of small size, if it has
ucts and processes not possessed by others and
tains continuous innovation. In many industries,
ver, efficiency by world standards must be
ted with size as cost will depend on scale. View-
s position as a producer, each country will wish
courage its industries to be as strong as, or stron-
han, those of other nations. However, as a
uming country it hates having in its economy an
try which is strong enough to dominate a
cular sector of its consumption requirements. It
s face this conflict of attitude in its anti-trust
and will tend, rather than resolving it, to try to
both desires.
ttitudes within a country are ambivalent it is
that different countries will display different
des, both in their anti-trust laws and in the
ct that is paid to them by their nationals. It is
d so. The more highly industrialized a country
more, and more complex, rules it has. The
rowth—or perhaps, more correctly, the
encement of serious enforcement—seems
ally to have occurred after considerable
trialization has taken place. Enforcement agen-
erefore frequently find a situation which would
e present had the current policy of enforcement
applied at an earlier stage.[1] Learning no doubt
the example of the United States, countries are
developing—though *perhaps not enforcing*—
rust legislation at an earlier stage of their
trialization than did the pioneers in this field.
des vary from country to country, not only
use of different temperaments and history, but
ecause of different industrial situations. Every
ry needs to maintain, and if possible increase,
nomic strength.
ose that live by industrial production will
t certainly be industrial consumers also, and
e faced to a greater or lesser degree both by
to see its industry grow in size and strength and
r of the giant within its borders.
ose countries which have themselves a market
ently large to sustain two or three or more
eting companies, each of which is already big
gh to obtain all the economics of scale to be
etitive with large companies in other parts of
orld, can afford to be more absolute in their
de against mergers.[2] They do not need any more
ate giants by diminishing the number of
etitors within their own economy. A smaller country, with a home market which can sustain only one company efficient enough by world standards to compete with the giants, may find it wise to allow mergers even if they result in only that *one company* and a lessening of competition within the *country*.[3] Such a country will also have to consider its policy on *imports* to provide sufficient, but not too much, competition from this source.

As barriers to international trade diminish and it becomes easier to trade across borders there will be room, even in smaller countries, for organic growth of more companies than would be justified while there is a substantial dependence upon a home market.

Furthermore, each country will wish its industry *not only to get bigger* in its own country in order to *obtain* export business, but to become strong enough *to establish itself* wherever possible in overseas territories. It will face in this connection the difficulty *of balancing* its immediate financial position with the *ability to allow the necessary* outflow of capital in *order* to obtain the eventual return. Conversely, it will be reluctant to permit the establishment of foreign giants within its borders.

This balance is the subject of much economic argu*ment on which I* am not competent to comment, but I note it as one of many factors, outside the control of the international or would-be international firm, which affects the movement of industry from one country to another. This factor, however, is linked with an anti-trust factor. An inability to provide capital from home base will severely limit the possibility of an acquisition in another country or the creation of a new wholly-owned company there. It will therefore accentuate the preference for a joint venture, which preference, in the case of a sophisticated manufacture, requiring complicated plant manufacture, and a knowledge of local marketing requirements, will be there for other reasons. It will be easier to make a merger or acquisition in a smaller country than in a larger, because of the necessarily less absolute attitude in the smaller country.[4]

It is generally the case that those who have pioneered and developed a policy, particularly if circumstances in their own country are favourable to its wholehearted adoption, come to believe that that policy is one that should obtain universally throughout the world. It will become an article of faith, and they themselves will develop a crusading fervour. It is so with anti-trust. Just as the democratic nations of the western world believe that parliamentary democracy is the panacea for so many of the world's evils, and should thus be adopted by all nations whatever the differing temperaments, condi-

true that antitrust policy cannot easily—and certainly not
y—solve problems of deeply entrenched power. Fifty years
ective public policy toward mergers resulted in unneces-
high concentration in many industries.'
ller, Select Committee on Small Business, United States
, 29 June 1967.
le in some industries technology may make it impossible
y small companies to operate efficiently, it does not dictate
both size and high levels of market concentration. Most
can markets have become so large that they can sustain a
considerable number of efficient-size enterprises.'
ller, Select Committee on Small Business, United States
, 29 June 1967.

3 'Broadly (the Government's policy toward mergers) may be summed up as follows. The objective is to increase industrial efficiency and international competitiveness.'

Board of Trade, *Mergers, a guide to Board of Trade practice* 1969.

4 '*If a firm is already large*, it has as a practical matter nothing to fear under antimerger provisions of the Clayton Act. . . . But if two medium-sized firms unite in order to deal more effectively with this giant, the law will be on them like a tiger. Again if large, you are exempt. If you seek to become as large, or even if you seek to become somewhat larger, although still much smaller, you are in trouble.'

Galbraith, Senate Select Committee, 29 June 1967.

tions and state of development of those nations, so the exponents of competition believe that that concept, if universally applied, is the touchstone that will create and control a business world with fairness to all, that will otherwise be a jungle in which the consumer will be victimized by the producer.

It has, of course, to be a controlled competition because, if uncontrolled, the victor will become powerful enough to destroy competition which will then have to be re-instated by action under anti-trust laws. Such a 'stop-go' use of anti-trust is, I believe, not inherent in a policy based on competition. Such a policy seems to me to be without doubt the correct basis for industry in our system of a free enterprise democracy.[5] But like many aspects of a democratic economy it must necessarily be the subject of compromise where all do not start on level terms. If the concept is treated as an ideology, not susceptible to compromise, it is an obstacle to any harmonization at international level of business practices, for communities which hold it as an article of faith are just those which would benefit most from its adoption, and they will be opposed by nations which cannot afford to adopt it so wholeheartedly and which will wish to retain rules which best suit their own economy.

We may, of course, see in the years to come the creation of more supra-national Authorities—or the adherence of more nations to such Authorities—which will produce supra-national anti-trust laws gradually to replace those of its member states, but for myself I am reconciled to the probability that, unless and until there is more even distribution of the world's wealth, there will be no one generally accepted—and generally applied—attitude to anti-trust on an international level—except perhaps in detail.

The international firm will therefore have to continue to study the national anti-trust provisions of each country to whose jurisdiction it is subject and conform as best it may with each of them.

There remains, nevertheless, some hope that, even if we are not to achieve one international attitude to antitrust, we may yet achieve some agreement on how to deal with conflicts between jurisdictions. I applaud the efforts that are being made to this end, but doubt if the solution lies in the formulation of international laws—rather in the consultation procedure exemplified in the EFTA Treaty.

If we are not to achieve harmonization on an international scale, can we see any amelioration of the complexities now existing among the national rules? Let us consider some of the differences that exist in the various anti-trust jurisdictions.

Commission act administratively or quasi judicially, the international firm in its operations in the United States will, in general, find a procedure that is operated wholly judicially. The EEC and some, if not all, of the member states act administratively (though, no doubt, quasi judicially) subject, however, to an appeal by persons aggrieved to a Court of Justice. Britain acts administratively in many matters, but usually only after consideration of an opinion given by an independent quasi judicial body.

Secondly, one can distinguish between those whose laws start with basic concepts of a very generalized nature, which become particularized either by judicial decision or by the issue of delegated legislation or administrative order which may be positive or nega-

cases, provision for authorization) building gradually up to a comprehensive code. In the former category is the United States, whose generalizations become particularized by judicial decision, and the EEC where we have the generalizations of Articles 85–6 followed by delegated legislation. Thereafter there have been the administrative or quasi-judicial rulings of the Commission and judicial decisions interpreting the Articles and the delegated legislation, and ruling upon the Commission's individual orders. I should add here that something of similar practical effect as the issue of administrative orders is being achieved in

rather than generalized.

Thirdly, I should like to note a difference in attitude to the purposes of anti-trust laws. There are those who regard anti-trust as part of a positive policy, of which there are many other facets, adopted by a country to shape and preserve its economy in the way best suited to it from time to time, and those who start with the thesis that industry is inherently likely to obtain economic power which it is inherently likely to use against the interests of all other sectors of the community and regard anti-trust as the negative weapon to frustrate these desires of industry. The difference in outlook may be likened to the difference between considering medical men as primarily to keep us healthy or primarily to cure us when we are ill.

Having looked at the anti-trust side, let me now turn to some aspects of industry. Industry is the bread-winner of the economy and if it is not healthy both the consumer and the economy as a whole will suffer. Industry is both buyer and seller, and the individuals who compose industry are members of the public and part of the economy, and as interested in the economy as any other sector of it. By its very nature industry is active—it is 'doing' all the time. Anti-trust is passive in the sense that, although it governs the conduct of industry, it has no role unless or until it is activated by an action or proposal of industry. The initiative comes always from industry, the response to that initiative from anti-trust. Speed is usually essential to industry if it is not to lose its opportunity—anti-trust such urge.

[5] It is however worth noting that, while it may be easy to define competition, it is often difficult to decide whether a particular act promotes or inhibits competition.

Industry is an aggregation of individuals, not all of whom can be expected to be familiar with anti-trust legislation though most will have some familiarity with their own. Those individuals responsible for management decision, however, will necessarily have to be familiar with many different anti-trust laws—sufficiently familiar at least to recognize the areas where they will require advice. This is a difficult task for those whose main experience lies in technology or marketing, and the difficulty is often underestimated by those who spend their entire life in a consideration only of anti-trust laws: they are often too apt to impute wickedness where ignorance is the real culprit In most branches of the law industrialists will be guided by an inherent ethical sense, but much of anti-trust is not based on natural ethics but upon artificial ethics which are not the same in all countries.

Having looked at both sides, let us look at some of the difficulties.

There will be very few industrialists today who would not agree that there must be anti-trust laws. A return to the simplicities of the last century in the complex situation of today's industrialized world would indeed lead to anarchy. But is the situation satisfactorily governed by today's anti-trust laws?

If conduct is to be regulated by law, then it is surely axiomatic that those whose conduct is in question should know what they are required to do or not to do. This requires that the rules should be ascertainable and understandable and should give a clear guide on conduct. But a subject as complex as anti-trust requires a considerable degree of flexibility, both because experience and the progress of thought will affect attitudes and perhaps substantive changes in the rules, and because some of the rules must necessarily be of the vague 'if and but' type, the application of which will certainly vary from time to time, but may also vary even between contemporary cases.

How then to reconcile the certainty which should be provided by the law and the flexibility required by the changing complexities of anti-trust?

Hitherto I have been considering anti-trust laws as a cohesive whole. There are, however, two quite distinct aspects, viz. those that are related to the structure of industry and those that constitute a code for the conduct of business. The latter corresponds roughly to the first two categories which I set out in paragraph 7, and the former to the last three.

A code for the conduct of business should be capable of precise definition and is eminently suitable for judicial process and the adversary procedure that this entails. It is not so defined, however, in many jurisdictions. In the United States, for example, where the legislature has enacted only basic concepts, the list of permitted or forbidden acts is evolving slowly from the decisions of the Supreme Court and the courts of many Federal Districts. Admittedly legislative prohibitions would evolve slowly too, but those prohibitions would be effective only from the date of the enactment. A Court decision is declaratory of the law as it exists, and one may well find oneself sued for an action carried out long prior to the decision of the Supreme Court (perhaps by a majority—perhaps overruling a Court of Appeals) declaring it illegal. If it needed the decision of the Supreme Court, can an industrialist be blamed for not having known it before? If he is blamed he will consider it unfair where the blame really lies with the uncertainty of the rules he is supposed to follow. Common Law Courts have always brought Common Law principles up to date and thus the law has always been evolving, but prior to the last two decades the evolution had been gradual and the course predictable.

Today, however, the Courts are making new law—in many cases at variance with what it was previously thought to be. Several responses are made to those who complain of this:

(a) So many laws are required nowadays that the legislature hasn't time to consider and enact them.

This seems to me a poor reason. They must either delegate their legislative powers—a solution that is not popular in the Common Law countries, but is, nevertheless, the way that Britain is going—or we should have a duplicate legislature with a division of functions between the twins.

(b) The adversary procedure is better adapted than legislation to ensure good law, because the decision will only have been taken after full argument, and the arguments will have been presented by a representative of those affected by it.

The same result can be obtained by delegated legislation if those entrusted with it consult with those affected by it before it is made.

(c) It helps to curb the power of industry if there is some uncertainty about the law and the law is flexible enough to catch undesirable acts which it had not previously been thought necessary to forbid.

For every act of this kind there must be many which would not have been committed had it been clear that they were forbidden.

(d) That it is never difficult to discern those practices which are likely to be under attack and one can avoid trouble by avoiding them.

It is true that anti-trust authorities throughout the world are becoming much more forthcoming in publishing their views of what should or should not be forbidden, and of course industry is grateful for such guidance. I suppose that if one follows this guidance one is accepting rule by administration. Acceptance of this, however, by one party to a negotiation does not avoid practical difficulties. Let me give you an example. Is it permissible in the United States, when granting a licence under a patent, to take a covenant from the licensee that he will not contest the validity of the licensed patent? This is a practice considered quite proper in other jurisdictions, and many consider it ethical, particularly in those cases where the licensee is being admitted to the knowledge of accompanying know-how. An inability to insert it may well put the licensee into the position of being able at once to suspend royalties by claiming that the patent is invalid. If several years later he fails, he has his licence to fall back upon and he has lost nothing. If, however, it is illegal in the relevant

jurisdiction, the covenant cannot be inserted. But is it illegal to insert it in a licence under a United States patent? It has been clear for some time that it is unwise to do so. Nevertheless, in a speech on the 5th June this year, Mr McLaren, US Assistant Attorney General, speaking of practices which are condemned under the anti-trust laws, said: 'I am speaking of such practices as . . . agreements to refrain from challenging the validity of patents *under which no licence has been granted*' (italics supplied). I know of at least one licensor who, on reading that, at once queried the correctness of the advice he had previously received. I understand that a Complaint has now been filed which, if it reaches the Court, will decide the point. But what of the situation in the

[illegible]

leaves the licensee in the position outlined above, but you find that your proposed licensor insists on such a clause, either because he takes a different view of the outcome or because he wants to maintain his position in the meantime. It begins to look a little like a poker game. Unless you can argue him out of it you will either have to take the licence with the covenant or refuse the licence. Either way you are worse off than your licensee. Would not this very simple point have been a suitable one for legislation?

Rules relating to the structure of industry are in a different category. There must necessarily be flexibility. Policies may alter. Different industries may require different treatment. Ethics—even the artificial ethics of much of anti-trust law—hardly apply. Is this really fit subject for judicial process? Is it not

[illegible]

dustry contemplating an alteration to its structure needs to know at once whether it is an alteration which might be considered objectionable. It is then in the interests of the industry, its customers, employees and the country as a whole that a decision shall be reached with speed.

One can say of the judicial process and the adversary procedure that it is thorough, will explore the position in depth and will ensure that all aspects are considered. Can one say that it is speedy? Can we afford the time that it will take, the dislocation that will be caused during that time and the manpower engaged upon its debate? If the volume of such business increases at the present rate, will the Courts—or the anti-trust authorities—be able to cope in ten years' time, even with the substantial time lag now customary?

This question is particularly pertinent if such business consists not only of dealing with questions of proposed or currently formed structures, but also includes the jobbing back to look at structures already formed which are thought either to have been wrongly formed in the first place or to have got out of hand since.

Of course, even administrative or quasi-judicial procedures can take time. Some of the explorations of an industry in depth by the Monopolies Commission have taken an inordinate time.[6,7] I am tempted to believe that if they had allowed themselves—or been allowed by industry—to dig only to a quarter of the depth they would have come up with precisely the same answer.

We must surely shorten our procedures and be content with less exhaustive reviews of individual cases. The EEC Commission show signs of adopting this philosophy. It remains to be seen whether industry is prepared to acquiesce in decisions made on such shortened reviews, in the interests of getting on with the job, even if they believe them to be misconceived.

The shortest procedure of all is to obtain guidance and the views of the anti-trust authorities on what is proposed to be done. Both the United States and

[illegible]

Clayton Act and will therefore be 'challenged'. The latter takes a neutral attitude to all mergers but sets out certain considerations which will be applied when deciding if the merger will be 'referred' for consideration as to whether it is in the national interest. The 'challenge' and the 'reference' point the difference between an adversary and an administrative approach. An industrialist will wish no doubt to resolve any uncertainties as to the view which will be taken by discussion with the authority concerned so that each side can see and understand the attitude of the other before any formal steps are taken.[8] Some time ago, I believe, Dr Turner issued an invitation to industry to discuss particular problems with the department. No statistics are, of course, available, but has that invitation been generally accepted? Such an invitation seems to me to hold the best hope for more understanding between industry and the anti-trust authorities, and to remove the antagonism that I fear is induced by an adversary system, particularly where the investigator is also counsel for the plaintiff. It would be a pity if the invitation were regarded in the same light as the spider's to the fly.[9]

A discussion of particular problems between industry and the anti-trust authorities seems to me to be sensible for both sides. Much trouble is caused by a lack of understanding. Industry tends to assume, perhaps fallaciously, that anti-trust authorities are staffed by civil servants or lawyers who have no understanding of the problems and difficulties of industry. I am aware of Dr. Turner's quotation from

[illegible]

[8] The difficulty of deciding what is the market that one would be considering is notorious. '. . . a definition of the market so loose and unprofessional as to be positively embarrassing'. (see *Trust Task Force Report*, 16th June 1969.)

[9] The Task Force appointed by President Nixon recommends a general policy statement to achieve (inter alia) the purpose 'To revive and strengthen . . . bad [illegible] business man' (italics from original).

(Page 55, 516 CCH [illegible]).

Shaw: 'I do not need to have laid an egg in order to tell a bad one when I see it'. True, but is it not an advantage to know why the egg was bad and what are the practical difficulties in ensuring that all future ones are good? If there can be no movement of people from industry into anti-trust as there is the other way, should not industry be enabled to assist, if not in the formulation of anti-trust policy, at least in indicating the difficulties in its enforcement and any unforeseen consequences of the policy? I have already made plain my view that delegated legislature is a necessary evil and preferable to the creation of new law by Court decision. One further reason is that industry can help in just this way in the enactment of such legislation. Though I'm not sure if they are going to get it right in the end I believe the Board of Trade would agree that the comments on the practical effects of the original form of the proposed Statutory Instrument on information agreements have been of considerable value.

Let me state some propositions which I believe merit discussion:

(a) Laws regulating conduct should ideally be simple: sometimes they have to be complex. Anti-trust laws are unnecessarily complex.
(b) Anti-trust procedures are at present far too long and cumbersome and inhibit unnecessarily the efficient conduct of business.
(c) There is an antagonism between anti-trust and industry which is far greater and deeper than is necessary or desirable. Unless the two sides can consult freely, both as to the form of legislation and as to the feasibility of particular courses of action, this antagonism will get worse. Such consultation should shorten procedures, lead to a greater understanding of anti-trust policies and of the practical difficulties of industry, and is the likeliest way to produce order in the industrial scene.
(d) We should distinguish more clearly between those anti-trust laws which govern the conduct of industry and those which relate to the structure of industry.
(e) Those laws which govern the conduct of industry should be clearly and accurately defined by legislation and should, so far as possible, relate to the conduct itself and not to the motives underlying that conduct.
(f) The flexibility needed for the rules relating to the structure of industry should be achieved by administrative or quasi-judicial procedures and the adversary procedure inherent in the judicial process should be avoided as far as is practicable.

In conclusion, may I say that I am only too well aware of the patchwork effect of this paper. Some of the pieces have got out of order, some don't seem to fit, some of them may be upside down and I have seen the wrong side of them. They are simple homespun pieces, but I hope that the participants in the discussion can make something of them.

Although the questions I raise based on these shreds and patches are elementary and have been debated many times before—as it seems to me have all other aspect of anti-trust—I think it not inappropriate that at the end of a conference largely devoted to more esoteric questions we should finish at what is, after all, the starting point of all anti-trust.

4.6 The international aspects of the United States anti-trust laws

W. L. Fugate

The United States anti-trust laws have until very [illegible] the international aspect of monopolies, mergers and restrictive practices must necessarily take into account the United States experience in this area, the present paper is submitted as a summary of the pertinent court decisions in the United States in this area.

The Sherman Act,[1] the basic anti-trust law expressly forbids restraints upon, and the monopolization of, commerce between the United States and foreign nations. This law enacted in 1890 is actually not the oldest of the anti-trust statutes since Canada enacted its criminal law against restraints of trade in 1889. In 1894 Congress reiterated the Sherman Act and practically re-enacted it with special emphasis upon imports into the United States. These were the anti-trust provisions of the Wilson Tariff Act[2] and this link between tariffs and the anti-trust laws is significant. When the Sherman Act was passed there was a strong *movement to provide that tariffs on foreign products* should be lifted in the event of restrictive trusts in the United States since according to this argument '. . the most effective way to deal with trusts . . . is to repeal the tariff duty and place the foreign article on the free list.' Such a provision has never been added [illegible] sion Act of 1962 on which the Kennedy Round of tariff negotiations was based, authorizing the President to withhold or withdraw tariff concessions if any nation 'tolerates international cartels . . . unjustifiably restricting United States commerce.'[3]

In 1918 Congress enacted the Webb-Pomerene *Export Trade Act*[4] *as an exception to the Sherman* Act and this law in general authorizes American companies solely engaged in export to band together in selling for export, the Act authorizing such companies to fix the prices and co-operate in shipping *their products to foreign countries* The legislative history of this Act indicates that Congress intended it to be a very limited exception however, and the Act provides that an association's acts and agreements must not be in restraint of trade within the United States or *in restraint of the export trade of any domestic competitor* Such an association also may not enter into any agreement or do any act which artificially or intentionally enhances or depresses prices within the United States of commodities of the class exported or which substantially lessens competition within the United States or otherwise restrains trade therein

The courts have also construed the Webb-Pomerene exception narrowly, and in the 1949 *Alkali* case,[5] a district court in New York held that a Webb association is not authorized to join a foreign cartel. Later, another district court found illegal an arrangement whereby four-fifths of the abrasives industry joined in a Webb association and entered into arrangements for joint production abroad with the explicit or implicit understanding that the *members of the association would not export from the* United States in competition with their joint factories abroad The Supreme Court last year decided an interesting case relating to Webb associations In the *Concentrated Phosphate Export Association* case,[6] the Court held that the Webb Act does not apply to procurement by the United States Government for shipment abroad in connection with the foreign assistance program. The rationale of the Webb Act in 1918 was to enable United States companies to combine to meet large foreign cartels, a purpose which is not relevant today, and the Department of Justice has more than once advocated its repeal.

It is significant that with a very few exceptions the United States anti-trust statutes do apply to foreign commerce[7] and that Congress in amending the anti-trust laws from time to time, *such as increasing the* fine under the Sherman Act from $5,000 to $50,000 and in passing the anti-trust Civil Process Act in 1962 have applied such amendments equally to foreign as to interstate commerce. Thus, the Clayton Act applies

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1 15 USC, sec. 1 et seq. (1964).
2 Sec. 73-7, 15 USC, secs. 9-13 (1964).
3 19 USC, sec. 1862(b)(3) (1964).
4 15 USC, secs. 61-5 (1964).

5 *United States v. US Alkali Export Ass'n*, [illegible] (1949).
6 *United States v. Concentrated Phosphate Export A*[illegible] 199 (1968).
7 15 USC sec. 18 (1964).

in general to foreign commerce and the Celler–Kefauver amendments to Section 7 of that Act passed in 1950 apply to acquisitions in foreign commerce whenever the other prerequisites of the statute are met.[8] The Department of Justice under this statute successfully attacked the acquisition by the Schlitz Brewing Company of a block of stock of the Labatt Brewing Company of Canada.[9] Although there the court was perhaps primarily concerned with competition between Schlitz and a US subsidiary of Labatt in California, it also relied upon the potential competition which the Canadian company offered for the US market. On the other side, the Department challenged an acquisition by Aluminum Limited of Canada of an American company in the aluminium fabricating field. This was settled by a consent divestiture decree but the Canadian firm was later relieved of the obligation to sell by the American court.

Another case which occasioned considerable comment in the European press at the time was the *Mobay* case,[10] settled in 1967, a suit under Section 7 of the Clayton Act involving the joint venture in the United States between Monsanto Chemical Company and Farbenfabriken Bayer, AG of Germany. This complaint was based upon the effect of the joint venture to restrict competition between two of the world's largest chemical companies in the fast growing market for plastic foam raw material in the United States. It may be noted that Bayer under the consent decree was enabled to buy the entire joint venture company.

The underlying rationale of the application of the anti-trust laws to foreign commerce is the same as that regarding interstate commerce, that is, as the district court said in the 1945 *National Lead* case[11] (affirmed by the Supreme Court), the major premise of the Sherman Act is that 'the suppression of competition in international trade is in itself a public injury or at any rate suppression is a greater price than we want to pay for the benefits it sometimes secures'. According to the court, 'In the long run, competition is a more effective prod to production and a more trustworthy regulator of prices than even an enlightened combination.'[12] This statement merely echoes the interpretation of the Sherman Act by the Supreme Court. As stated by Justice Stone, for example, '. . . it cannot be doubted that the Sherman law and the judicial decision interpreting it are based upon the assumption that the public interest is best protected from the evils of monopoly and price control by the maintenance of competition'.[13]

As a matter of giving the essential framework of the application of the anti-trust laws to foreign commerce, reference will be made to some of the leading cases which show the development of the jurisdictional doctrine and the basis upon which the anti-trust laws of the United States are applied to acts and activities in our foreign trade, some of which may sometimes be outside of its borders. It is rather remarkable that there are less than a dozen Supreme Court cases dealing with anti-trust restraints on United States foreign commerce. The few Supreme Court cases, however, do not indicate the activity in this area since from 1940 to the present there have been roughly 200 anti-trust foreign trade cases and there were a great many prior to 1940. By far the greater part of these cases were settled by consent judgements, or on the criminal side, by nolo contendere (no contest) pleas.

The first case in which the Supreme Court had occasion to deal with restrictions on United States foreign commerce was a case which now is not a precedent in its main holding. This case, interestingly enough, was a private treble damage action in 1909 entitled *American Banana Company* v. *United Fruit Company*.[14] The complaint by an American company alleged monopolization of the United States import of bananas by United Fruit Company and specifically the seizure by that company of plaintiff's banana plantation in Costa Rica and other acts designed to prevent the plaintiff from exporting bananas to the United States from Costa Rica in competition with United Fruit Company. Justice Holmes, in that famous case, concluded that acts abroad could not form the basis of an action under the anti-trust laws of the United States. That part of the opinion is certainly not valid today and has been, for all practical purposes, overruled by later cases. The holding in the *Banana* case which is still good law is that the acts of a sovereign nation in its own territory are not subject to United States anti-trust laws, and as this doctrine has been refined, that actions of private parties abroad within a country which are required by the laws of that country are not, as such, subject to the United States anti-trust laws.

It was not long before this limited view of United States foreign commerce as applied to the anti-trust laws was changed. Among other cases, the Supreme Court two years later in the *American Tobacco* case of 1911[15] condemned an arrangement whereby the American Tobacco Co. in the United States and the British Imperial Tobacco Company in Great Britain each agreed to sell only in its own country with third countries being served jointly or split between them.

The case of *United States* v. *Sisal Sales Corporation*[16] in 1927 somewhat modified even the exception in the *Banana* case with respect to acts required by foreign law. In that case the complaint alleged a conspiracy to restrain trade and to monopolize trade in sisal, a Mexican plant used for binder twine most of which was imported from Mexico and Yucatan. According to the complaint several United States commercial and banking companies and a Mexican corporation had conspired to obtain control of the foreign supply of sisal and to monopolize its import into the United States. The parties had influenced discriminatory legislation in Mexico and Yucatan and one of the

8 15 USC, sec. 18 (1964).
9 *United States v. Schlitz Brewing Co.*, 253 F. Supp. 129 (D. Cal. 1966), aff'd 385 US 37 (1966), rehearing denied, 385 US 1021 (1967).
10 *United States v. Monsanto Co.*, 1967 Trade Cas. para. 72,001 (WD Pa. 1967).
11 *United States v. National Lead Co.*, 63 F. Supp. 513 (SD NY 1945) aff'd, 332 US 319 (1947).
12 63 F. Supp. at 525.
13 *United States v. Trenton Potteries Co.*, 273 US 392, 397 (1927).
14 *American Banana Company v. United Fruit Company*, 213 US 347 (1909).
15 *United States v. American Tobacco Co.*, 221 US 106 (1911).
16 *United States v. Sisal Sales Corp.*, 274 US 268 (1927).

companies had become the sole purchaser of sisal from producers and the Sisal Sales Corporation became the sole importer into the United States.

The Supreme Court found a conspiracy to restrain United States imports which was not exempted from the anti-trust laws merely because part of the acts and agreements took place in foreign countries. Further, the mere fact that discriminatory legislation was obtained as part of the scheme did not bring the arrangement under the exception of acts within a foreign country required by foreign law.

The Supreme Court in 1962 in the case of *Continental Ore Company* v. *Union Carbide and Carbon Corporation*,[17] took occasion expressly to affirm the doctrine of the *Sisal* case and to state that defendants' reliance upon the American *Banana* case was misplaced in the light of later cases in the Supreme Court. The complaint in the *Continental Ore* case, a private treble damage anti-trust case, brought under the Sherman Act, asked [illegible] charged that joint action by other United States vanadium producers, and the Canadian subsidiary of one of them had cut off its opportunity to export to Canada. The gist of the complaint was that the Canadian subsidiary of defendant Union Carbide, Electro Met of Canada, appointed as the exclusive wartime agent to purchase and allocate vanadium for Canadian industries, had contracted exclusively to purchase from the other defendants. The complaint asserted, moreover, that the Canadian market was divided between defendants Union Carbide and Vanadium Corporation of America.

The Supreme Court reversed the lower court's decision not permitting evidence of these facts, holding that the evidence should have been presented to [illegible] complained of occurs in foreign countries'. The Court noted that plaintiff did not question any action taken by the Canadian Government and found no charge that any Canadian Government official 'approved or would have approved of joint efforts to monopolize the production and sale of vanadium or directed that purchases from Continental be stopped'.

Perhaps the most notable case in the United States on the jurisdictional aspect of the application of anti-trust laws to foreign trade is the *Alcoa* case (*United States* v. *Aluminum Co. of America*)[18] decided in 1945 by a statutory court in lieu of the Supreme Court. The opinion written by Judge Hand concerned primarily the question of monopolization of the United States domestic market by the Aluminum Company of America (Alcoa) but the case also had a very im- [illegible]

Limited, a Canadian company [illegible] took jurisdiction because [illegible] States. It was also an affiliated company of [illegible] principal defendant. Aluminum Limited, as the court found, was a member of an [illegible] which included a French corporation, two German corporations, a Swiss corporation and a British corporation, banded together in another Swiss corporation referred to as 'Alliance'. These were all aluminum producers which joined to allocate on a quota basis the amount of aluminum to be produced. These companies expressly included in their quota arrangement the United States market.

In considering this situation, Judge Learned Hand, for the court, stated that 'Two situations are possible. There may be agreements made beyond our borders not intended to affect imports, which do affect them, or which affect exports.'[19] Judge Hand then went on to say that almost any limitation of supply of goods in Europe or in South America might have repercussions in the United States if there were trade between the two. He continued, however, that as to agreements outside of the United States intended to affect United States imports and actually affecting them, the United States courts had a legitimate jurisdiction. Accordingly, the court having found that these two elements were satisfied here, it enjoined Aluminum Limited from entering into any cartel or agreement like that of the one in question in 1936, covering imports into the United States.

From a jurisdictional standpoint Judge Hand laid down the rule that it was 'settled law' that 'Any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends; and these liabilities other states will ordinarily recognize....'[20]

It may be noted with respect to the *Alcoa* case that this was the rare situation of a court holding illegal actions outside of the United States taken entirely by foreign parties. While Judge Hand chose to treat the situation thus, it must be recognized that the actions of Aluminum outside of the United States and affecting the United States market were certainly not done without reference to the activities and position of its affiliated company, Alcoa, the largest aluminum company in the United States. This view is reinforced by the fact that in 1951 Judge Knox in the Southern District of New York in formulating the final relief in the *Alcoa* case, decreed that the common stockholders of Alcoa and Aluminum Limited would have to divest themselves of the stock of one company or the other.[21]

The American Law Institute, in its Restatement of the Foreign Relations Law of the United States (American Law Institute Publishers, St Paul, Minn., 1965), has substantially endorsed the *Alcoa* view of jurisdiction. Section 18 concludes that a state has jurisdiction to prescribe a rule of law attaching legal

[17] *Continental Ore Co.* v. *Union Carbide & Carbon Corp.*, 370 US 690.
[18] *United States* v. *Aluminum Co. of America*, 148 F 2d 416 (2d Cir. 1945).
[19] 148 F 2d at 443.
[20] *Ibid.*
[21] *United States* v. *Aluminum Co. of America* [illegible] 1950).

Alkali case[28] is in point, in which a dominant group of United States alkali producers, including two export associations and a British corporation, admitted agreements among themselves and other foreign producers, including I G Farben, the giant German chemical company, to allocate world markets in alkalis. The defendants relied on the exemption of the Webb Act, but, as noted, this was held to be no justification. The court found that the stability of the United States domestic price of alkalis was due to the defendants' use of their export associations to dispose of excess supply abroad when it would tend to depress the price in the domestic market.

The *Sisal* case which I have mentioned,[29] illustrates arrangements to gain control of foreign supplies for the [illegible]

[illegible] *companies concertedly forgoing exports from the* United States in order to manufacture in factories abroad which they owned jointly to serve foreign markets. It should be stressed that this is perfectly all right if one company does it alone, and there are many reasons today why a company may wish to pursue such a course independently. The court held that such a combination not only restrained the export trade of the participants but, more importantly, restrained the trade of competing United States domestic exporters and potential exporters since the latter had to face the joint operation abroad. The joint ownership in the foreign factories was eliminated in the final judgement, the court allowing one company to purchase the entire interest in a factory.

The restraint of United States imports or exports and the exclusion of competitors in support of a domestic monopoly is illustrated by the *Incandescent Lamp* case.[31] The General Electric Company (GE) [illegible] into 'home' markets, in which the local participants had a preponderant share, and joint territories in which each such participant had a fixed quota. Domestic licensees under GE's patents were restricted in their exports. The court found that as one means [illegible] licensees for the same purpose.

The most recent case in the United States on this point is the 1969 case of *Zenith Radio Co. v. Hazeltine Research, Inc.*[32] There the Supreme Court affirmed the lower court's holding of illegality in the participation by a United States company in a foreign patent pool which was designed for, and had the effect of, preventing United States exports of radio and TV sets to Canada. While pools in the United Kingdom and Australia were also involved, it was held that other factors than the pools prevented export to these countries. This was a private case but followed an earlier Government case settled by consent decrees prohibiting other United States companies from directing their subsidiaries to participate in the same Canadian pool.

The anti-trust aspects of cross licensing and patent pooling in international commerce situations under United States law was emphasized in the 1963 *Singer* case.[33] The case also indicates that the United States enforces its anti-trust laws even where the result might appear contrary to its own commercial interests. That complaint charged Singer, the sole American manufacturer of household zigzag sewing machines, with combining with two European manufacturers to use their United States patents to keep out the competi- [illegible] upon a new improved household sewing machine. Both foreign companies were selling sewing machines in the United States. Ostensibly the latter agreement was to settle a patent contest in the United States Patent Office. Each party, however, agreed to facilitate the allowance in any country of patent claims as broad as possible on the conflicting patents, and Singer was given the right to enforce the Swiss company's United States patent. The Supreme Court held that the arrangement was illegal as a concerted effort by competitors for the purpose of protecting the parties against competing Japanese importers.

The United States experience shows that it is feasible for a country through its national laws to deal with restraints upon its foreign commerce, and that such enforcement can be effective. Indeed as other countries have enacted anti-trust laws, they too have come to realize the desirability, if not the necessity, of covering acts and agreements adversely affecting their home markets even though such acts and agreements may be in part outside of their territory.

Thus in the recent *Dyestuffs* decision,[34] the European Communities Commission noted that this was the first time that a decision of prohibition involved not only companies in the Common Market but companies having their headquarters elsewhere. The action regarding the latter, the Commission said, 'could be included in the scope of the decision because the restrictions of competition to which they were party affected the situation within the Common Market'.[35]

The Canadian Restrictive Trade Practices Commission made a similar statement in a Report on Shipping Conferences:

> The Commission considers that where any overt act which takes place in Canada flows from an agreement which is contrary to the public policy, public interest or public order of Canada, such agreement comes within Canadian jurisdiction even if it was not made in Canada. In such circumstances, even if the agreement does not violate the law of the country where it was made it is within the purview of the Canadian courts. In the present

28 *United States v. US Alkali Export Ass'n*, 86 F. Supp. 59 (SD NY 1949).
29 Supra, note 16.
30 *United States v. Minnesota Mining & Mfg Co.*, 92 F. Supp 947 (D Mass. 1950)
31 *United States v. General Elec. Co.*, 82 F. Supp. 753 (D NJ 1949); 115 F. Supp. 835 (1953).
32 *Zenith Radio Co. v. Hazeltine Research, Inc.*, 395 US 100 (1969).

33 *United States v. Singer Mfg Co.*, 374 [illegible]
34 *CCH Common Market Reporter*, [illegible] (1969)
35 Ibid.

instance, the agreements were acted upon in Canada and had clear effects in Canada.[36]

Of course, unilateral national enforcement has its problems. There are difficulties for a national enforcement agency to obtain files outside its territory and often some of the participants may be outside of the jurisdiction. Also, on occasion there may be protests from other governments as to decrees, for example, affecting its nationals.[37] Further, from the point of view of freeing international trade, purely national enforcement by one country may only incidentally take care of restraints on the trade of other countries. The question of some international procedure to deal with restraints upon international trade has been considered many times. As yet, efforts in that direction have not met with success.[38]

In view of the present lack of any international anti-trust enforcement machinery, co-operation in national enforcement appears to be the logical answer to limitations in one country's capabilities and jurisdiction as well as to possible conflicts arising from different laws and different interpretations of jurisdiction. In 1960 the Contracting Parties to the General Agreement on Tariffs and Trade (GATT) recommended bilateral or multilateral consultations concerning harmful restrictive business practices in international trade. Under this suggested procedure, a member country should give sympathetic consideration to complaints of another member concerning such practices (presumably carried out by enterprises of the latter country), and they would attempt to reach a mutually satisfactory conclusion. The parties were to advise the GATT Secretariat of the conclusions reached or the failure to reach satisfactory conclusions. This GATT decision is included in the Appendix.

The present most promising step in the same direction is the 1967 Recommendation for anti-trust co-operation by the Council of the Organization for Economic Co-operation and Development (OECD). That Recommendation, which is also included in the Appendix hereto, recommends that the member countries co-operate in three areas with respect to international trade anti-trust matters:

1 Notification of actions by one country under its anti-trust or restrictive business practices legislation affecting the important interests of another country;
2 Co-ordination of action under national laws where appropriate and practicable (notification is to take place in advance if possible, so that there may be an opportunity for the expression of views by the country notified, and to take account of possible remedial action the latter may wish to take under its own laws); and
3 Exchange of information on restrictive business practices to the extent permitted by their national laws and legitimate interests.

The OECD Recommendation is being implemented and hopefully further international co-operation will ensue in the restrictive business practices area.

36 *Restrictive Trade Practices Commission, Shipping Conference Arrangements and Practices* (Ottawa, 1965). See also *OECD Comparative Summary of Legislations in Europe and North America on Restrictive Business Practices*, McGraw-Hill & Co., US, and 'Scope of Legislation' at pp. 109–13.
37 *See* Brewster, *Antitrust and American Business Abroad*, 46–51 (1958); Fugate, *Foreign Commerce and the Antitrust Laws*, 46–7 (1958).
38 *See* summary in Loevinger, 'Antitrust Law in the Modern World', 6 ABA Section of *Int. & Comp. Law Bull.* 20 (1962).

APPENDIX

Decision of the Contracting Parties to the General Agreement on Tariffs and Trade at their 17th Session, 18 November, 1960.

Having considered the report (L/1015) submitted by the group of experts, which was appointed under the Resolution of 5 November 1958, and related documents,[1]

Recognizing that business practices which restrict competition in international trade may hamper the expansion of world trade and the economic development in individual countries and thereby frustrate the benefits of tariff reduction and removal of quantitative restrictions or may otherwise interfere with the objectives of the General Agreement on Tariffs and Trade;

Recognizing, further, that international cooperation is needed to deal effectively with harmful restrictive practices in international trade;

Desiring that consultations between governments on these matters should be encouraged;

Considering, however, that in present circumstances it would not be practicable for the contracting parties to undertake any form of control of such practices nor to provide for investigations, the contracting parties

Recommend that at the request of any contracting party a contracting party should enter into consultations on such practices on a bilateral or a multilateral basis as appropriate. The party addressed should accord sympathetic consideration to and should afford adequate opportunity for consultations with the requesting party, with a view to reaching mutually satisfactory conclusions, and if it agrees that such harmful effects are present it should take such measures as it deems appropriate to eliminate these effects.

And *Decide* that

(a) If the requesting party and the party addressed are able to reach a mutually satisfactory conclusion, they should jointly advise the secretariat of the nature of the complaint and the conclusions reached;
(b) If the requesting party and the party addressed are unable to reach a mutually satisfactory conclusion, they should advise the secretariat of the nature of the complaint and the fact that a mutually satisfactory conclusion cannot be reached;
(c) The secretariat shall convey the information referred to under (a) and (b) to the contracting parties.

General Distribution
Paris, 10th October 1967
C(67)53 (Final)

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Council
Recommendation of the council concerning co-operation between member countries on restrictive business practices affecting international trade

(Adopted by the Council at its 149th Meeting on 5th October 1967)*

The Council,

Having regard to Article 5(b) of the Convention on the Organisation for Economic Co-operation and Development of 14th December, 1960;

* The Delegate for Switzerland abstained.
1 The related documents are L/1287 and Add. 1, L/1301, L/1333 and W.17/23.

Having regard to the Resolution of the Council of 5th December, 1961, concerning Action in the Field Restrictive Business Practices and the Establishment of a Committee of Experts [OECD/C(61)47 (Final)];

Having regard to the Report by the Committee of Experts on Restrictive Business Practices concerning Co-operation Between Member Countries on Restrictive Business Practices Affecting International Trade [C(67)53],

Recognising that the diminution of free competition through restrictive business practices may have an adverse effect on achievement of the trade-expansion and economic-growth aims of Member countries as set out in Article 1 of the Convention;

Recognising that closer co-operation between Member countries is needed in this field but that the present powers of the authorities of Member countries to co-operate are limited to various degrees;

Recognising, moreover, that the unilateral application of national legislation, in cases where business operations in other countries are involved, raises questions as to the respective spheres of sovereignty of the countries concerned,

Considering therefore that a closer co-operation between Member countries in the form of consultations, exchanges of information and co-ordination of efforts on a fully voluntary basis should be encouraged it being understood that such co-operation should not in any way be construed to affect the legal positions of Member countries with regard to such questions of sovereignty, and in particular the extra-territorial application of laws concerning restrictive business practices, as may arise,

I **Recommends** to the Governments of Member countries

1 (a) That in so far as their laws permit, when Member countries undertake under their restrictive business practices laws an *investigation or a proceeding involving important interests of* another Member country, they should notify such Member country in a manner and at a time deemed appropriate. Notification should, where appropriate, take place in advance in order to enable the proceeding Member country, while retaining full freedom of ultimate decision, to take account of *such views as the other Member country may* wish to *express* and of such remedial action as the other Member country may find it feasible to take under its own laws to deal with the restrictive business practice.
(b) That where two or more Member countries proceed against a restrictive business practice in international trade, they should *endeavour to co-ordinate* their action in so far as appropriate and practicable under national laws.

2 To supply each other with any information on restrictive business practices in international trade which their laws and legitimate interests permit them to disclose.

3 To co-operate in developing or applying mutually beneficial *methods of dealing with restrictive business practices in international trade.*

II **Instructs** the Committee of Experts on Restrictive Business Practices to keep under review developments connected with the present Recommendation and to examine periodically the progress made in this field.

Group 5
Competition policy in relation to efficiency in distribution and other services

5.1 B Clement, Chairman's report

5.2 Sir Hugh Weeks, 'Competition and efficiency in distribution in Britain'

5.3 Sir Bernard Miller, 'Competition policy in relation to efficiency in distribution'

5.4 L A Skeoch, 'Some aspects of Canadian policy relating to distribution'

5.5 Miss M Gardiner Jones, 'Food retailing: a case study of United States anti-trust policy toward the distributive trades'

5.1 Chairman's report

B Clement

Like the previous speakers, I must begin by expressing my thanks. To the OECD, which has granted its patronage, to the Board of Trade which, after having arranged the conference, has ensured its success by

to Sir Hugh Weeks, who opened the debate by a report which embraced all its aspects, and to Sir Bernard Miller, Professor L A Skeoch and Miss Mary Gardiner Jones, whose reports, which were complementary to each other in many respects, provided the material for our work. Thanks to them, and thanks to the intellectual discipline of all the members of the group, my task has so far been easy. It is now that it becomes difficult, since I have to summarize briefly the essence of the contributions made by the various *participants.*

1. Just as distribution comes at the end of the economic process, my report on distribution also comes at the end. It will indeed be a report on distribution since, between the distant preparations for the conference and the present moment, there has been a double modification. Originally the subject of the group was *to be: 'Competition policy in relation to efficiency in services, including distribution.' In the first modification* the official subject became: 'Competition policy in relation to efficiency in distribution and other services.'

A second modification during the discussion has led to the disappearance of other services. This was despite

tects, lawyers and property agents. Sir Hugh omitted, quite deliberately, only the problem of transport, which he judged to be too complex, and that of commercial activities such as the hotel and restaurant trade, hairdressing and the vehicle repair trade, along with certain professions, all of which seemed to him to *be questions of minor importance compared with the* subject. The conclusion on services was not the subject of a true debate and, of course, concerns only the United Kingdom. In his view, in the banking sector, the Bank of England and the Treasury can act more quickly and more effectively than any legal authority or court, *in the professions, the only important* question is that of scales of fees and, provided that the recommendation is accepted that they should be fixed as maxima by the organizations outside the profession, no other action seems necessary

Despite my efforts as Chairman, no other intervention related to services. Personally, I regret this, since the services sector is one of those in which price *increases are most marked and most regular. Although* this can be explained in part by the importance of labour in costs, it seems to me virtually certain, at least in France, that the absence of competition is a factor in this worrying situation and I should have liked an exchange of views to have taken place. This was not the case and the discussion concentrated solely on the problem of distribution

2 Since the subject spoke of efficiency in distribution, it was naturally necessary to define this efficiency. It was said that it consisted in offering to the consumer the maximum satisfaction for the minimum cost. We adopted this definition while appreciating the great complexity of the first term (see Sir Hugh's report on this point) and the problems which the second term *presents. However, on the basis that among the satisfactions which the consumer might receive, an advan*tageous price for a given product was probably the main one, the group considered that the object to be achieved was to reduce prices without too seriously reducing the various services in relation to the sale, this, as was strongly emphasized, presupposes the coexistence of several types of trade

3 Can such a result be obtained without the intervention of the public authorities? There was a fairly

this sector can change his activities so as to turn towards the most profitable ones. Although certain participants—rightly in my view—were inclined towards this optimism, there is no doubt that entry is easier into trade than in most sectors of production

One of the reasons why the intervention of the public authorities is necessary is that the problems of distribution involve at least four distinct categories of

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interest: small retailers, who are not represented in the Group and who, at least in France, complain of the way things are developing; large retailers who are doing well and are content with the present state of affairs; producers, in themselves a not very homogeneous category; and, last but not least, consumers, who expressed their views with authority during the discussions.

4. The intervention of the public authorities may occur in two ways—that of action on structure, and that of action on behaviour.

With regard to action on structure, i.e. essentially the attitude to be taken towards the dangers of monopolization and towards mergers, it was very clear that there was a difference in the points of view expressed according to whether they came from the other side of the Atlantic or from this side. Miss Mary Gardiner Jones explained to us that the Federal Trade Commission devoted a large part of its activity to mergers, particularly in the sector which she had chosen to illustrate her remarks, namely, the retail food trade. This activity by the Federal Trade Commission has had the result, both desired and desirable, that mergers are no longer carried out on the initiative of large enterprises but constitute much more regroupings, capable of vigorous competitive action, of small and medium sized enterprises (the policy has been successful in its effort to channel mergers towards those firms whom growth by acquisition could be expected to make more efficient and more competitive).

As a sort of counter-proof, Professor L. A. Skeoch, sharing the same point of view, regretted that in Canada the action of the public authorities was too timid with regard to mergers, and that this reduced its overall efficiency in the field of distribution.

5. Concentration in the field of distribution aroused the same interest among members of the group belonging to other countries. Thus it could be said, without arousing much protest, that horizontal mergers rarely presented problems and that vertical mergers presented problems especially when the firm taking over already had, as producer, a near monopoly position.

Investigating the problem more deeply, large distribution enterprises were considered in their dual activity of purchase and sale. In the case of sale, it is the local market which constitutes the relevant market, although abuses can be committed on a local market by a firm which may provide compensations elsewhere. In the case of purchasing power, there is no doubt that the relevant market is the national market. The group accepted, it seems to me, that one could not adopt the same criteria as in the field of production, and that it is not necessary for the purchasing power to reach the level of one-third of the market (an unlikely hypothesis in any event) for producers to be very sensitive to it. A producer cannot lightly lose a customer who represents six, seven or eight percent of his outlets. This raises the problem of the relationship between production and distribution at a time when the respective forces of these two sectors, at least in certain countries and particularly in mine, are experiencing a very rapid development. One may wonder—the question was put strongly, particularly by Miss Mary Gardiner Jones—whether large buyers do not obtain advantages due to their size and not to their efficiency, and whether, per contra, small retailers will not be eliminated from the market, not by reason of their inefficiency but by reason of an unjust treatment resulting from their size. If it is considered that this is the case, or at least risks becoming so, a first remedy is to be sought on the side of the structure, in the development of 'voluntary groups', purchasing groups or chains formed around a wholesaler. The retailers thus grouped represent a bargaining power which enables them to obtain more advantageous conditions from their suppliers so that they can remain competitive. Legislation on restrictive practices should not be unnecessarily troublesome with regard to these groups and put them at a disadvantage compared with fully concentrated forms.

6. Since, at all events, this remedy is not a general one and does not have an immediate effect, the problem of unjustly discriminatory prices is not avoided. This leads us on from the field of structure to that of behaviour. This is a problem which was discussed, particularly this morning, with a great deal of vigour and a great deal of knowledge when Miss Mary Gardiner Jones, Commissioner of the Federal Trade Commission, was at the microphone. However, no very clear conclusion emerged from the discussions owing to the opposition of the points of view. The question was raised of whether the countries which have no legislation in this field ought to follow the American legislation by adopting 'something in the line of the Robinson-Patman Act.' I cannot say, speaking in the name of the Group, that a majority favoured a solution of this kind. The most that can be said is that in general the Group considered that there was, at least in the short term, a conflict between the interest of consumers and that of small trade, and that the arguments in favour of regulation in this field became stronger as the power of large retailers grew.

7. The second problem of behaviour, that of resale price maintenance, took much less time, since the system of resale price maintenance, which is on the retreat in all countries, hardly found any defenders. There was however general assent to Professor L A Skeoch's remark that the prohibition of resale price maintenance was not sufficient to bring about competition in the retail trade. A series of inter-dependent measures was necessary.

8. The question of refusal to supply is more complex. Everyone realized that the prohibition of resale price maintenance became completely ineffective if the producer was enabled to refuse to supply without valid reason; part of the group was inclined towards prohibition of refusal to supply, except in rare exceptional cases, while another part of the group considered that this would restrict excessively the freedom of producers in the choice of their strategy. This is certainly a problem which merits a more profound study than that we have been able to carry out.

9. Opinion was also divided with regard to recommended prices, some stressing their advantages, others showing themselves to be more aware of their disadvantages. The conclusion on this point could be that formulated in the United Kingdom by the Monopolies Commission, namely, that it would not be reasonable to prohibit recommended prices, but that it is necessary to exercise a good deal of vigilance in *regard to them.*

10. The development of distribution brands was generally regarded as legitimate and so far favourable to consumers. Some members pointed out the undesirable effect which these brands could have in too rapidly making new products commonplace, and thus reducing the profit which the producer can derive from innovation.

11. The group also considered the protection of the consumer from deceptions regarding either the quality of the product or the reality of a declared price reduction. In the United States the protection of the consumer is an important task of the Federal Trade Commission The British *Trade Description Act* was praised in certain respects, but subjected to detailed criticism.

12. Finally the group considered—thanks to a question raised by Professor L A Skeoch, which seems to have been echoed by all the participants—whether these problems of distribution could be resolved solely by prohibitions and as it were by force. The question was raised whether one should not show imagination and facilitate the necessary adaptations. Otherwise one runs certain risks. The first is that the victims of change become restless and agitate, as is happening at the present in France, and intervene with the public authorities so that laws, although necessary, are abolished or amended. Thus in Canada, amendments have weakened the severity of prohibition of price maintenance. The second risk is that unjust situations might be created. There is certainly no question of [illegible]

the adaptation of—and softening the consequences of—intervention by showing flexibility and imagination was, I think, supported by our group.

5·2 Competition and efficiency in distribution in Britain

Sir Hugh Weeks

The subject matter of this section is competition policy in relation to efficiency in distribution and other services. The distributive trades should be sharply distinguished from 'other services'. They are a link in the integral chain between manufacturer or grower or importer, and the consumer. Competition and efficiency in these trades is in large part dependent upon the policies and skills of their suppliers.

In this paper I am attempting to deal primarily with distribution but also to cover some important points in relation to other services. Since the purpose of this paper is to stimulate discussion, I feel it would be useful if I were to confine myself to the British scene and to see what conclusions might be drawn from our experience.

First of all, it is necessary to consider the two terms competition and efficiency. Competition in distribution is a continued attempt to give the customer what he or she wants. But what the customer wants is a complex specification which varies from person to person and is nearly always inconsistent. Although these specifications are largely undefined and sub-conscious, they can nevertheless be logically analysed under three headings:

(a) *Price*—which of course must be related to quality. While in some cases the customer may not be a particularly good judge of the appropriate relationship between price and quality, historically many innovations, new forms of retailing, have been launched on price competition.

(b) *Convenience*—which means the saving of time and this is a combination of convenient location (which itself depends upon the method of travel used) and the provision of a sufficiently wide range of goods. Furthermore, for many people the actual speed of the shopping operation is important.

(c) *Service*—the third element covers a wide variety ranging from the giving of advice to the giving of credit; from the provision of delivery services to the convenience of opening at times not convenient to the shop keeper; at the upper end of the trade there is that indefinable atmosphere which attracts the heavier spender and at the other end the homely gossip many shoppers enjoy.

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Since the job of the distributive system is to provide choices for individual consumers which approximate to the sort of mix they want, it is obviously extremely difficult to measure efficiency. One can do it in verbal terms by saying that it is a matter of giving the required mix at the lowest cost in resources, but how to evaluate the mix defeats measurement. Even the simple concept of added value can give the wrong answer, for the efficient operator working on cut margins may well appear to be less efficient statistically than someone who is working to full recommended prices.

Indeed, if we carry the crude test of the best use of resources to an absurd conclusion, we find that the ideal distribution system would imply large units in inconvenient areas with low rents; an even spread of the shopping load throughout the working day (that day probably being extended by shift operations); self-service with no delivery and no credit, and a narrow range of best selling goods in the shops, sometimes out of stock. One test of the relevance of legislation by the Government or of other influences on mergers and monopolies situations and the like, is that it should limit the concentrations of economic power which would prevent any group of consumers getting the mix they most require and are prepared to pay for. On the whole, the experience in the United Kingdom is that there have been substantial structural changes in distribution in the post-war period, leading to a concentration into fewer units and a movement towards the greater availability of a low-cost system, particularly in the field of grocery shops, which has combined lower price with less conventional services.

The British Authorities

Government efforts to increase competition and efficiency in the service sector involve, as for manufacturing industry, encouragement, control, or critical examination, by various bodies. There is a distinction between legislation affecting competition directly, and bodies set up by legislation which can only recommend on issues (generally of efficiency) remitted to them by a government department. In addition, the succession of Finance Acts and Companies Acts have had a less direct but nevertheless a very significant effect. Apart from administrative action which can be taken by government departments under existing powers, there are three main instruments of control or examination.

What is now the Monopolies Commission was set up in 1948 as the Monopolies and Restrictive Practices Commission. It examines a problem referred to it by the Board of Trade, and for this purpose a Monopolist is defined as one who controls one third of the market in question. It reports to the Board of Trade, but has no powers of enforcement. To date it has issued some fifty-one reports, generally the result of protracted examination of the issue. It has rarely made recommendations on distribution and the services specifically, but has frequently taken the distributive system into account when examining the subject of a particular commodity in which it might be thought a monopolist is operating against the public interest.

If the Commission finds that a particular situation is against public interest, the Board of Trade has a wide range of powers which, however, it is not bound to use. It can prohibit an acquisition; make a company divest itself of part of its assets; make it unlawful for a company to discriminate between customers; and make certain agreements between companies unlawful.

The National Board for Prices and Incomes, generally referred to as the PIB, was set up in 1965 primarily to report on proposed increases in prices or wages. It acts on the initiative of a number of government departments on a final reference of the Department of Employment and Productivity (formerly the Ministry of Labour). Again it has no powers of enforcement. In its shorter life the PIB has been extremely prolific and has now produced well over 120 reports, some of which will be referred to later.

The Department of Employment and Productivity (DEP) has various powers to delay increases in prices or wages which it can exercise before or after examination by the PIB; but most of these powers expire this year.

The third main instrument is the Restrictive Trade Practices Court and its principal officer, the Registrar. This body, which took over some of the responsibility of the predecessor of the present Monopolies Commission, arose from the Restrictive Trade Practices Act in 1956, and is also concerned with the operation of the Resale Prices Act of 1964 which, by abolishing resale price maintenance unless a case for retention could be proved, has had a powerful effect on the development of competition and efficiency in distribution.

There are other bodies which impinge.

The Local Authorities have local powers of planning; control of development; and local regulations which can have a strong influence on local competition and can only be upset by a complex appeal procedure. The Licensing Justices can restrict competition in selling wines and spirits.

Resale price maintenance

The protracted end of resale price maintenance has probably been a major influence on competitiveness in distribution. The theme was, in the words of the Attorney General of the United States: 'You cannot make people compete in price but you can by law prevent some from preventing others using price competition as a weapon'.

After protracted controversy and emotional debate, the Resale Prices Act which was passed in 1964 prohibited price maintenance by individual manufacturers. The collective enforcement of fixed prices had been prohibited unless justified before the appropriate Court, by the earlier 1956 Act. The original intention of the drafters of the Act was that any manufacturer wishing to maintain his prices would have to apply to the Court for exemption from the prohibition before he could do so. However, before the Bill was discussed in Committee, amendments were tabled by which a manufacturer who wished to maintain his prices merely had to register the fact with the Registrar of the Restrictive Trade Practices Court. The Registrar then had the duty of selecting cases to place before the Court and, until the Court had ruled, prices could be enforced by refusing supplies.

In fact in the grocery trade in particular resale price maintenance had largely broken down some years before, and it was estimated at the time the Bill was under discussion that only 25 per cent of all retail purchases were subject to price maintenance. In the early stages of the Act a number of intentions to maintain prices were filed Only two have been [illegible] argued that as the demand for its products depended largely upon impulse, it was dependent on a wide number of outlets, and that with the abolition of retail price maintenance the specialist confectionery shop would usually be at a disadvantage compared with supermarkets, who could selectively cut the leading lines. There would be a loss of convenience to the consumer as a result of fewer shops, restricted shopping hours and the narrower range of products available. Without retail price maintenance the industry felt it would no longer be able to exercise the same degree of authority, and that margins and consumer prices in the long run would rise.

The judgement of the Court was that there might be some rise in the margins and prices in other outlets, but the consumer might also benefit from lower prices in the supermarkets. Therefore, there was unlikely on balance to be much change in the overall price level, and retail price maintenance must be discontinued.

So far the total level of consumption has hardly changed. The initial reductions 'across the board' have given way to more permanent shallow cuts on higher priced items and 'multi-packs'. The most important development has been the use of price-cutting as a peg for promotional efforts, generally supported by special bonuses or discounts from the manufacturer. The end of resale price maintenance accelerated the changing trends in sales outlets: an increase in grocery-type sales, specially in supermarkets, and a decline in independent confectioners — a trend expected to continue.

The tobacco industry made an application under the terms of the Resale Prices Act 1964 to maintain resale price maintenance for tobacco goods. The provisions of that Act limited severely the argu[illegible]ts which the industry could put forward, and

considerable research and preparation conducted over a period of some four years, the industry, after taking the advice of leading counsel, decided in September 1968 not to proceed with its case. At the present time it is estimated that about a quarter of all cigarette sales are at cut prices: half of smokers say they never buy at cut prices. The average cut is now about 4 per cent of the recommended retail price: which means that cigarettes are perhaps 1 per cent cheaper over all. The change in outlets parallels what happened in confectionery; with an even bigger swing to supermarkets.

The sales of branded shoes sold through independent retailers account for about a third of the market and the manufacturers argued that these retailers, while protected by resale price maintenance, were able to stock a wide range of needs and employ skilled assistants, and that without this expertise feet would be damaged. The Court accepted that manufacturers could restrict sales to certain types of shop provided that the test they applied was not a fear of price cutting. The whole question of 'refusal to supply' is now under examination by the Commission.

The effect of the demise of resale price maintenance has not yet been the subject of statistical measurement. The general impression is that in many consumer goods there is still comparatively little price competition, and that this is currently most intense in drink—especially spirits; electrical products; paint; and tobacco. Price competition in new cars is clearly growing now that the restraint of resale price maintenance has been removed, though as in the past price competition effectively takes the form of a higher trade-in value for a second-hand vehicle (few first purchases are for a new car).

It seems clear that the substantial rise of the market share of the supermarkets in the grocery trade has been associated with the gradual ending of resale price maintenance. So far the most apparent effect of the passing of the Act has been that the larger supermarkets are widening the range of goods which they handle to include those which show the greatest elasticity of response to price-cutting, such as cigarettes and confectionery; paint; and electrical products. Their extension into the liquor market is primarily restricted by the need to secure a licence from the local Justices. This growth in the strength of the supermarkets and multiples (which have become virtually synonymous in our vocabulary), has had two effects. The first is that it has increased the power of distributors vis-à-vis manufacturers. Because of the importance to manufacturers' total profits, of increased sales at marginal costs the power of a large distributor to stock or not to stock a particular product enables him to secure more favourable terms, in the form of special discounts.

How far this change in the balance of power is in the end desirable is a matter for debate. Some distributors have used their buying power to improve the efficiency of their suppliers by enforcing standards of quality and manufacturing skill. Others have forced quality down by insistence on lower prices which may or may not have been passed on. In other cases the distributor has been able to sell his own branded lines on the strength of his own reputation for quality: and the cost to him has not carried the general advertising expense which the manufacturer has to incur. In all cases this buying strength is likely to lead to the declining importance of smaller retailers which is currently a feature of the British scene.

A second effect of the growth in the multiples and supermarkets has been that the independents in the grocery field (and increasingly in other trades) have banded together in voluntary groups under the leadership of one or more wholesalers so that sufficient buying power can be generated to secure terms comparable to those given to the large chains. The concentration of retail members' purchases through a single wholesaler has clearly also increased the efficiency of the distributive system.

Finally the growth in competition has led to the sensational increase in what are called cash and carry wholesalers, where the smaller independent retailer collects and pays cash for what he wants on more favourable terms than any wholesaler can offer who delivers goods and grants credit. On the whole, however, the natural and obvious effect of the end of resale price maintenance has been to make price a more important factor to both the final customer and the retailer, and to lessen the value placed upon service.

It is probable that even without the Act, price maintenance would have ended for many products, particularly in the current times of restrained domestic demand, but clearly the passing of the Act accelerated the movement.

Two issues arose from the ending of resale price maintenance. The first was whether the manufacturer should be permitted to continue to recommend retail prices. Arguments in favour of this practice are that the manufacturer is able to advertise what is likely to be a maximum price and thus to indicate the competitive position of his product, while the consumer is better able to judge the amount of the price reduction, if any, which is offered by a particular shop. The argument against this practice however is also twofold. Firstly, that if a price is suggested it becomes more likely that a large number of retailers will adopt it. And secondly, that there is a risk that manufacturers might suggest excessive resale prices so that it would appear that certain retailers were giving bargains more exceptional than was truly the case, while others, who were able to adhere to the recommended price, would be making what could be regarded as an excessive profit. The matter was referred to the Monopolies Commission, who came to the conclusion that on the whole the practice was not one which was against the public interest or any restraint on competition, but suggested as a long-stop action that the Board of Trade should keep an eye on the position and should intervene if the practice appeared to be abused: it is unclear whether this will be by administrative or judicial action.

The second consequence which is now under examination is the question whether manufacturers should have the power to refuse supplies to their customers. This arose particularly from the conflict between specialist distributors—for footwear for example—and supermarkets. When the super-

market cuts prices, then specialist shops threaten not to stock branded goods which are cut in price. The response of the manufacturer in the case at issue was to [illegible] manufacturer making this decision, unless he is himself in a monopolistic position. The counter-action of the distributor refusing to sell a particular brand could clearly not be the subject of legislation. Many [illegible] bers of the public? And is the power in the Resale Prices Act that manufacturers can refuse to supply retailers using their products as a loss-leader justifiable? My own answer in each case would be yes: though it might be added that the history of price- [illegible]

Monopoly in distribution

It is clearly difficult to define a monopoly in this [illegible] list is selling one-third of a particular group of commodities? Unless the monopolist distributor (however defined) is in a position to press the manufacturer to refuse supplies to other outlets, it must be expected that in the great majority of cases the abuse of monopolistic power by the retailer to the consumer would in a short time encourage either new outlets or existing outlets to start selling the goods in question. This line of argument suggests that if the monopoly test is to be applied, it should be at a substantially higher level than the one-third that is applied in manufacturing. On the other hand, there clearly can [illegible] sensible to regard a single shop in a village as a monopolist.

Mergers

The main arguments for large-scale horizontal mergers in manufacturing industry are firstly that a superior management may be applied to a less well managed company; secondly that economies can be achieved through concentration and rationalization of production research and development; and thirdly that a wider base is provided for export marketing. The last argument does not generally apply in distribution though there are possibilities, not yet widely exploited, through acting as export wholesalers, setting up branches abroad and reciprocal agreements with overseas distributors. In practice the second reason is less applicable because of the importance of location (except for wholesalers), leaving the first reason as the main economic justification, though the problem remains of the shortage of first class shop managers. The counter arguments are also less strong. The exercise of monopolistic powers is less likely and any possible consequential redundancy in areas of high unemployment would be of a very limited scale.

I suggest therefore that there is less cause for supervision and control and interference in horizontal mergers than may be claimed to be the case in manufacturing industry.

The next question is whether a different attitude should be taken towards vertical mergers, between a manufacturer and his distributive outlets. This seems to me to depend solely on whether the manufacturer is himself a monopolist. If so, then this is a situation which calls for examination. If not, it seems improbable that having a tied distribution system could cause a monopolistic situation which would not otherwise have existed.

A much more important effect which may well be exercised well below the conventional one-third level, is the problem of monopsony—that is of buying power exercised against suppliers. It is apparent that even at the present levels of concentration large retail groups are able to secure additional discounts because of their buying power which need not be related in any way to savings in the physical costs of distribution to their headquarters or to their branches. This is to the advantage of the large retailer irrespective of his efficiency and means that the traditional test of relative profitability between different organizations can fail to reflect their relative efficiency. This situation therefore raises the question as to whether something on the lines of the Robinson-Patman Act, by which the lowest price charged by the manufacturer depends on the size of a consignment, is desirable in Britain; and in considering this question we must bear in mind the very considerable possibility of evasion. A relevant issue is the justification in some trades of the practice of giving discounts to wholesalers which are not available to retailers doing a comparable volume of business.

Restrictive Trade Practices Acts

These acts are concerned with agreements on the production or supply of goods and so they apply to [illegible] Court, and required all agreements to be registered with the Registrar of Restrictive Trading Agreements. The Registrar was given the duty of taking proceedings before the Court (subject to directions by the Board of Trade) in respect of these agreements. Subject to the de facto discretion thus given to the Registrar, in that at any one time the number of agreements on the Register would be far too great for all to be brought before the Court, there was little theoretical discretion as to whether or not an agreement, once on the Register, went before the Court. The Registrar had and has considerable de facto discretion as to whether or not a registrable agreement exists in any particular case, subject to the ruling of the High Court. The Board of Trade

to order, if the Registrar recommended it, that agreements 'of no substantial economic significance' could be removed from the Register. The 1968 Act has given far more administrative discretion to the Registrar and the Board of Trade. 'If it appears to the Board of Trade, from the representation of the Registrar, that the relevant restrictions accepted under an agreement . . . are not of such significance as to call for investigation by the Restrictive Practices Court, they may give directions discharging the Registrar from taking proceedings in the Court in respect of that agreement during the continuance in force of the directions' (Section 9 (2)). As will be seen, this is a far reaching amendment, and in fact substitutes an administrative procedure for a judicial one. It may be argued that the agreements which are likely to be dealt with under this section would probably not have come before the Court in any case. None the less, the cost of arguing a case before the Court is formidable, and many useful agreements which include clauses that are technically registrable should benefit from the change.

The fact remains that the procedure appears to be a somewhat cumbersome one: first of all parties wishing to enter an agreement, or a trade association wishing to make a recommendation to its members, have to discuss with the Registrar whether or not the agreement is registrable, and possibly changes may be recommended at this stage to make it not registrable. If the agreement is registered, and they decide to go ahead, subsequent negotiations are necessary to decide whether or not the restrictions are likely to be of such significance as to call for investigation. Clearly the procedure could and should be simplified, particularly as the process of submission of a possibly registrable agreement can be expensive and time consuming, particularly where lawyers are needed.

Having considered procedure, let us consider the effect of the Acts on distribution. It clearly favours the multiple organisation with a number of units under its financial control, for instructions given to branches on prices, promotions, policy, opening hours and the like would of course not fall foul of the Acts. On the other hand, if a voluntary group which is developed to compete with the multiples sends similar instructions or even makes suggestions to its members on exactly the same points, this would appear to be a registrable agreement, although it might not be considered to be of such significance as to call for investigation by the Court. Even more difficult is the position of trade associations—defined in the Act as bodies formed 'for the purpose of furthering trade interest of its members'. Even advice given by an association to its members which is designed to increase their efficiency would probably be regarded as a registrable agreement. The problem is intensified when information agreements have to be registered. Obviously 'advice' by a trade association could be a device to get round the Acts. But advice by trade associations is given irregularly and on special issues. It is highly questionable whether it is sensible to try and stop this being done except on some price issues. The delay arising from the consideration of registration in any case makes nonsense of the situation. Apart from this, many members may not take any notice of advice. The coverage of a trade association in terms of outlets or turnover is frequently below the monopolist test of a third and the distinction between impartial information and partial advice is one at which the mind boggles. Broadly speaking it seems likely that the application of Restrictive Trade Practices Acts to distributions is frequently irrelevant: takes no account of the widespread and flexible competition within the distributive system, and is likely to impede the desirable efforts of voluntary groups and trade associations to improve the efficiency of members.

But it would be wrong not to have any restrictions at all on trade associations. A possible procedure would be for trade associations to be required to send a copy of any recommendation they make to members of an official body which would advise them if they were 'getting near to the wind'; in this way trade associations could continue to give valuable advice to members. There should probably be a ban on price recommendation by trade associations except where the association is acting as a trading body—e.g. a voluntary group and, even in this case, recommended prices should never be allowed to be enforced.

Effects of tax

In the 1966 Budget the Selective Employment Tax (SET) was introduced and since then has been twice increased. It is in simple terms a poll tax which now reaches £2 8s a week on employed men not engaged in manufacturing. It was intended to make distribution and the services less competitive in bidding for labour against manufacturing and other untaxed activities. It has therefore had a powerful effect at two extremes of the distributive system. Self-service employs fewer persons in relation to sales than the conventional shop and there is little doubt that the tax has accelerated the trend towards self-service which was apparent before it was introduced. At the other extreme the tax also favours the family shop, since self-employed persons do not pay SET. The tax has a distorting effect in the field of wholesaling. The employees of a manufacturer who are engaged in distributing a product to retailers are clear of SET. The employees of a wholesaler who is performing precisely the same function are however liable; despite the fact that in the majority of cases wholesale distribution is a more efficient channel using less resources and causing less traffic dislocation.

Selective Employment Tax is not the only fiscal discrimination between retailing and all other activities of the economy. Investment grants, whereby the Government itself pays a percentage of expenditure on investment in plant and machinery, are confined to manufacturing and no expenditure in distribution is eligible.

State and local authorities

Regulations on cleanliness, weights and measures, qualifications of pharmacists etc. are clearly desirable and if uniformly enforced must be regarded as essential even if perhaps they do restrict competition

in certain areas. The most contentious regulation is the control of shop hours. Without going into detail, the main points at issue are whether shops should be [illegible] existing type of regulation are that there is less risk of shop labour being exploited: not so much counter staff as the managers of small branches: while it is suggested that if late evening and Sunday opening became very general, this would not lead to any increase in the total of transactions carried out by all shops but would increase the total cost of the distributive system because of the necessary double shifting or overtime which would be necessary. On the whole the fears may be thought to be somewhat exaggerated, since few shops at the present time take advantage even of the present statutory limits. There might indeed be less objection to widening the hours if an alternative restriction was passed on the number of hours that a shop was open in a particular week, or, if it would not fall foul of the Restrictive Trade Practices Act, for the shops in a particular district to reach an agreement on how they would take economic advantage of greater flexibility. The main point that arises on this is the degree to which the system should cater to the minority consumer. There are probably few people who would want to shop after 8 o'clock in the evening, but on the other hand, many of them would find it inconvenient to shop at any other time.

The recent Trade Descriptions Act (1968) which applies to retailers who mislead the customer, is a safeguard to the consumer, and places all retailers at some risk, but generally must favour the better organized and more honest. The provisions in the Act about [illegible] which goods of the same description were previously offered by him. Certainly no objection can be taken to it on the grounds of restriction of competition or the effect on efficiency.

In the development of new shopping areas, either by local authorities or commercial operators, the problem arises that the rents needed to make a new site profitable are inevitably much higher than the rentals of the demolished properties. There is some evidence that this results in the strengthening of multiples and a reduction in the number of independent traders since they are not prepared or unable to take the risk of paying high rentals without the certainty of off-setting trade increase. In some cases there may be implicit restriction on competition with the offer of unique opportunities for a particular trade. But since the conventional boundaries between trades are becoming increasingly blurred, this can hardly be regarded as of any serious significance.

So far there has been no official suggestion that entry into distribution should be restricted to those who are qualified through skill and capital resources. I doubt whether such an application of professional standards of competence would in fact have much effect on the competitive situation. It might indeed lead over a period of time to a marginal increase in efficiency, but would, I suggest, be more of a protection to the incompetent entrant who might go bankrupt, and to his suppliers, than it would be to the consumer.

The main conclusions I draw from British experience are:

(i) The passing of the Resale Prices Act accelerated an existing trend and this was a desirable piece of legislation. No further action is required on the topic of recommended prices, over and above what the Monopolies Commission recommended.

(ii) The present method of operation of restrictive practices legislation is too cumbersome, and a more flexible, largely administrative approach should be adopted. The present restrictive effect on new forms of organization and the weakening of the advisory powers of trade associations outweigh the very limited advantages.

(iii) In the present state of play the danger of monopoly and mergers in restricting competition is far less in distribution than in manufacturing, while the advantages of mergers in leading to greater efficiency are also probably less and probably slower to achieve.

(iv) The effect of legislation (including fiscal measures and the actions of local authorities) have united to accelerate a trend towards larger and fewer units, providing lower prices and fewer conventional services. The squeeze has been on the so-called independents which provide advantages of location and service. This is a trend which could eventually be against the interests of minority groups of consumers but that contingency is some way off.

(v) There is considerable scope for increased efficiency in distribution and this is most likely to come from continued unfettered competition and the minimum of regulations, (other than those which protect the public from misrepresentation and risks to health) and from better educated and more selective consumers.

Other services

Although distribution is the main subject of this section we also include the complex area of other services. I propose to confine myself in this survey to the banking sector and certain professional services. I shall omit from the survey such service industries as hotels, catering, hairdressing, garages, and the medical and accountancy professions, since in most of these fields the issues we are here considering appear to be relatively unimportant. The most important service industry not covered is transport, which is too complex to be included in the space of this paper. Clearly these areas are not barred from the discussion which will follow in the next two days.

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in certain areas. The most contentious regulation is the control of shop hours. Without going into detail, the main points at issue are whether shops should be permitted to stay open after 8 o'clock in the evening and on Sunday. The arguments for greater flexibility are primarily the advantage of the consumer and of course complete flexibility of opening would produce additional competition for trade done during the present hours. The arguments for maintaining the existing type of regulation are that there is less risk of shop labour being exploited: not so much counter staff as the managers of small branches: while it is suggested that if late evening and Sunday opening became very general, this would not lead to any increase in the total of transactions carried out by all shops but would increase the total cost of the distributive system because of the necessary double shifting or overtime which would be necessary. On the whole the fears may be thought to be somewhat exaggerated, since few shops at the present time take advantage even of the present statutory limits. There might indeed be less objection to widening the hours if an alternative restriction was passed on the number of hours that a shop was open in a particular week, or, if it would not fall foul of the Restrictive Trade Practices Act, for the shops in a particular district to reach an agreement on how they would take economic advantage of greater flexibility. The main point that arises on this is the degree to which the system should cater to the minority consumer. There are probably few people who would want to shop after 8 o'clock in the evening, but on the other hand, many of them would find it inconvenient to shop at any other time.

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The banking sector

The banking sector, which includes the clearing banks, the merchant banks, branches of foreign

banks, discount houses and finance houses, is controlled partly by long-standing convention and partly by instructions or guidance by the Treasury and the Bank of England which, although nationalized, acts as a powerful independent force. The clearing banks work to conventional rates of cash and liquid assets to liabilities and, in addition, at the present time their lending to the private sector is limited to ceilings imposed by the authorities, while for other banks, other conventional ratios govern the amount of various types of finance which the Bank considers should be undertaken.

The private banking sector is dominated by the large clearing banks, which now fall into four major groups, involving subsidiaries and associated banks which often continue to operate under their own name and with their own branch system. Last year one important merger took place in this field, and another was not approved. Any merger of the clearing banks requires the approval of the Bank of England and for many years it had been assumed that any merger between the big five would not be approved. However, in May 1967 the Prices and Incomes Board in a report on banking charges commented that the Bank of England and the Treasury would not obstruct amalgamations. The merger of the two smaller members of the big five (National Provincial and Westminster), was approved by the Bank of England and not referred to the Monopolies Commission; the new group accounted for about a quarter of clearing bank deposits. Within a few days a further proposal was made for the merger of three independent banks—Barclays, Lloyds and Martins, which would together have accounted for nearly half the total deposits. This proposal was referred to the Monopolies Commission and after an exhaustive enquiry it was not recommended by a six to four majority. No objection was taken to a merger between Martins, much the smaller of the three, and either of the other two, and in the event Barclays took over Martins. It appeared that the main reasons why the authorities decided to refer this merger to the Monopolies Commission was that if it had been agreed there might later be irresistible pressure for the two remaining groups (Midland and National-Westminster) to merge, thus creating a duopoly.

The majority view was that the economies and increase in efficiency estimated to follow from the merger would not off-set the risk arising from reduction in the number of sources of conventional banking finance; that there would be some inconvenience from the closing of branches and that competition between the groups would be reduced.

The minority report shared the view that a two-bank system would clearly be against the public interest, but considered that the merger would stimulate more competition from the two smaller groups and from other sources of finance, and that the economies suggested would be an improvement worth securing.

In the main report the Commission commented upon what it called the 'soporific effect' on joint-stock banks of the cartel-type agreement under which the banks pay two per cent under bank rate on deposits and agree the minimum charge over bank rate for certain classes of overdraft. The Prices and Incomes Board also recommended competition and the dropping of the agreement. On this matter there appears to have been a change in attitude of the authorities. In 1963 the then governor of the Bank suggested that competition in deposit rates should be considered; in 1968 the authorities' opinion was that competition in deposit rates would tend to increase the cost of borrowing permanently, with adverse effects on trade and investment. The defence of the clearing banks was that they have funnelled competition in deposit rates into hire-purchase and finance house subsidiaries or associates.

A new element in competition for deposits has arisen from the many American banks which have opened branches in London and one indeed has already indicated that it will not in future automatically tie interest rates to bank rate.

Another issue of interest concerns the publication of accounts. Banks in the United Kingdom are permitted to accumulate hidden reserves which only recently have been disclosed to the Bank of England and the Board of Trade. Both the Monopolies Commission and the Prices and Incomes Board suggested that the publication involved no risk to the leading clearing banks and should be a stimulus to competitive efficiency now lacking. The reply of the authorities was that this would be considered after further evidence had been accumulated.

It seems to me possible that once the present abnormal conditions are over, the clearing banks may well adopt a more aggressive attitude in competition for business, stimulated by the American branch banks and the merchant banks. Up until now the banks have normally competed on service, and this has been primarily through the opening of additional branches in convenient locations. The result of the mergers has been that this form of competition will be less important as the number of banking groups reduces.

Another indication of the 'cartel-type' approach of the clearing banks has been the combined decision not to open on Saturday mornings—a decision caused by the difficulty of staff recruitment, and the practice of American and Continental banks. One reaction, the scale of which it is difficult to assess, is that 'non-banks'—primarily shops which are open on Saturday—are proposing to provide cheque-cashing facilities, staffed in some cases by moonlighting bank employees.

Britain—especially Scotland—probably suffers from an excess of bank branches, but it would appear that it will be some years before the major mergers which have taken place will appreciably reduce the number—largely because of the physical difficulty of handling the work of two branches in one unit. This may be expected to increase efficiency of operation and indeed was a powerful argument put forward in the Barclays/Lloyds submission. A more immediate effect on efficiency would seem likely to come from the use of common services, especially computers, between members of a group.

In general it may be said that for most of the post-war period any controls exercised over the banking sector have been primarily determined by the short-

term needs of economic policy, and that the consequence upon operating efficiency has taken second place. Over the last two years in particular, and in the near future, this priority seems to me to have been inevitable.

Another important group is the British banks who *primarily operate overseas—generally concentrating* on particular geographical areas. Here mergers are frequently rumoured and are particularly desirable in order to provide units of a size which can match the ability of the larger American banks to finance large-scale international trade. This argument indeed was another put forward in the Barclays/Lloyds submission. The effect of the American banks operating in London has already been referred to. While they provide more competition in deposit rates, the main purpose of their entry has been to be able to operate in the Euro-dollar market, and consequently their judgement of the appropriate rates of interest has been influenced by what has been happening in this very volatile market.

The merchant banks, although providing some of the services of the clearing banks (with much greater flexibility in deposit and lending rates) are primarily concerned with operations in the money and capital markets; investment advice; foreign exchange dealing, arranging new issues and the master-minding of mergers and take-overs on which fresh competition has been introduced by the state financed Industrial Reorganisation Corporation. The recent struggles have caused the unwritten rules of this last game to be codified by a takeover panel with no powers other [illegible] may be introduced, although this will be an extremely complex field to cover.

On the legal side the main influence in these operations comes from the various Companies Acts, the latest of which requires additional disclosure of turnover, exports and directors' salaries. The effect of this on competition cannot yet be assessed. Such disclosure is more feared by small firms than large, partly because of the innate habits of secrecy of the small firm, and partly because the large firm's figures include so many varied activities that the trends of competitive interest are difficult to disentangle.

One particularly interesting example of the acknowledged operation of a restrictive practice is provided by the discount market. In return for a collective undertaking to subscribe every week for all the Treasury bills on offer, the 11 discount houses are allowed to put in an agreed uniform tender in competition with a few other houses who deal as principals, and with banks who are tendering on behalf of their customers. But the discount houses are so dependent on the Bank of England as a lender of last-resort when money is short, that it may be assumed that they act in broad conformity with the Bank's wishes as conveyed to them shortly before the tender.

Reference was made earlier to the fact that the clearing banks have substantial interests in hire purchase or finance companies. These companies themselves have been a subject of numerous controls on the terms on which they may do business: primarily changes in the initial deposit and the permitted length of the repayment period. In all cases these have been proposed because the authorities wished to reduce or expand the amount of credit, but within these regulations competition is active on interest rates and their borrowing is at competitive market rates.

Insurance

[illegible] can begin business. Competition has been extremely active, and particularly in motor car insurance this attempt to limit new entrants has not stopped some spectacular failures. It is now accepted that tighter and continued control by the Board of Trade on newly formed companies is necessary if the public is not to suffer. The main impingement of the Monopolies Commission in this field has been on the question of the charge for what is called the green card—that is the extension of a normal motor car policy to cover driving abroad. By agreement between the companies a standard charge of £2 had been made. The Commission decided that this standard charge should be discontinued, principally on the grounds that it was excessive. However, the reference appears to have caused some companies to make a closer assessment of the actual costs which they incur, and the perverse consequence of the Commission's recommendation has been that in some cases the cost of the green card has risen.

The professions

Charges made by architects and solicitors have been referred to the Prices and Incomes Board, and the activities of estate agents to the Monopolies Commission. Architects, in common with consulting engineers and quantity surveyors commonly work to minimum scales determined by their various professional associations. It is frequently contended that a fee dependent on actual cost does little to encourage the most efficient building. Even before the reference, departures from the scale were not unknown, particularly as all three professions are open to the growing competition of the 'turnkey' contract by the construction company which employs its own professionally qualified staff and quotes for a building with architectural and engineering services, often in competition with other firms of the same character. This system, naturally suspect to the pure professionals, may well be in the interests of efficiency, and since the second greatest living reinforced concrete engineer works in this way in Italy, the method has perhaps gained in respectability. The conclusion of the Prices and Incomes Board was that the scale and fees should not be determined by the RIBA, the professional association of the majority of architects, but by an independent reviewing body which would issue non-mandatory guidelines which would particularly include reductions in the scale for large or repetitive works, and further that the

architect's fees should cover fees charged by other specialist consultants providing services outside the architect's own ability.

These professions, in common with doctors and solicitors, do restrict competition by not permitting advertising by members of their partnerships. They have to rely on reputation and recommendation, and in many cases on the associations which they have been able to develop with supplementary professions.

Solicitors, whose charges were also referred to the Prices and Incomes Board, are not of course exposed to the external competition to which architects and consulting engineers are subject. Their fees were referred to the Prices and Incomes Board because of an increase proposed by the Law Society, their governing body, in the fees to be charged in the grant of leases, and for county court work. In the examination by the PIB it was agreed that conveyancing generally should be included. A different conclusion was reached here on fees. It was that for conveyancing charges should be reduced and should continue to be subject to reviews, similar to that made by the Prices and Incomes Board, but should only be treated as a maximum, while for charges determined by the solicitor himself, to which no rules apply, the Board suggested that charges should be related to time spent The charges made by estate agents were referred to the Monopolies Commission—it will be observed that what appear to be similar issues are not confined to one or other of these two instruments of recommendation. Briefly, the conclusion was that standard rates for estate agents' fees should be discontinued; that members should be allowed to compete for business on the basis of fees; and finally that the registration of estate agents should become a statutory requirement.

It will be seen that in all four cases which have been referred to, the same conclusion was reached. It was that scales of fees determined by a professional association should either disappear or should cease to be mandatory, or should be determined by some outside body. And one assumes that the same lines would be taken with any other similar cases. Although clearly the three professions referred to are the most important ones to which such practices now apply, nearly all the professions have in common that their association rules preclude the protection of limited liability. The partners' whole fortune is at risk in catastrophe, and although most risks can be covered by insurance it might be thought that this might limit new entrants. However, there is no evidence that this is so, and clearly there are more than enough units in the profession to provide effective competition if restrictive practices are reduced. But this partnership form has important tax implications. Briefly, it is an advantage to the small firm but a deterrent to further expansion when a certain level of profits per partner has been exceeded. This is because the high rate of personal tax which is applied to the partners' earnings makes it more difficult to accumulate working capital than would be the case in a limited company, subject to Corporation Tax. It is of course arguable that the very large professional firm may not be more efficient than the medium-sized. But clearly the combination of high personal tax and the partnership principle lessens the incentive for the growing firm to b[e] more efficient.

Conclusion

This superficial survey suggests there is no clea[r] for the application of the Restrictive Trade Pr[a] Act to the sale of services as well as goods. In th[e] banking sector the Bank of England and the T[r] can act far more quickly and effectively than a[] Registrar or Court.

In the professions the only issue of importanc[e] the self-determined scale of fees: and provided [] recommendation is accepted that these are to b[e] determined by external bodies as maxima, no f[] action would seem to be necessary.

5.3 Competition policy in relation to efficiency in distribution

Sir Bernard Miller

In his paper as Introductory Speaker Sir Hugh Weeks has surveyed the whole field of governmental and other action that bears upon competition in distribution, and this paper attempts to provide more detail on some parts of the picture he has drawn. It will accordingly be somewhat disjointed; it deals mainly with matters within my own personal experience either as a member of the Monopolies Commission or as a practising distributor.

Work of the Monopolies Commission

I look first at the work of the Monopolies Commission, to see what indication it gives as to official policy from its own conclusions and from the Government's acceptance of them. Although the references to the Commission of monopoly situations among distributors have been rare, many of the references in respect of manufacturing industries have been chiefly concerned with issues of distribution. The framework within which the Commission does its work is of course set by the legislation under which it was created. This is primarily in the Monopolies and Restrictive Practices (Inquiry and Control) Act, 1948 and subsequent legislation.

The monopoly conditions are defined as at least one third of the goods in question being supplied by or to any one person or by or to any two or more persons, being either interconnected bodies corporate or persons who so conduct their affairs as to prevent or restrict competition in production or supply. The Commission could be required to report either the facts only or both the facts and whether they operated, or might be expected to operate, against the public interest. For any single business or group of connected businesses, the size of the share of the market by itself could bring them under enquiry. For two or more separate persons, there must be collective agreement to prevent or restrict competition.

The work of the Commission made it clear that for single businesses or interconnected groups, it was not a monopolistic position per se which was against the public interest, it was whether use was made of it to prevent or restrict competition and this was clearly at the core of all the references. The Act itself went no further than the implication that prevention or restriction is something that should put the practices upon enquiry. The Commission's reports, however, show that its own thinking went beyond this and amounted virtually to presumption that prevention or restriction of competition was against the public interest unless it should be proved to the contrary. For example, in the Wallpaper Report (1964) there is reference to the 'disadvantages inherent in the suppression of competition'. The principal disadvantage in respect of distribution was reckoned to be that lack of competition impeded the promotion of efficiency and the reduction of costs and prices.

Collective restriction of competition

Initially the work of the Commission was mainly concentrated upon the collective aspect and there was throughout the period up to 1948 and, indeed, thereafter, a considerable body of opinion that many of the actions that the Commission found to be against the public interest when practised collectively, were not to be condemned when practised by single businesses. Thus in 1920 considerable merits were seen in fixed retail prices and investigation would be needed only where monopoly strength was exercised to fix prices that secured excessive profits. The Committee on Restraint of Trade in 1930 was not satisfied that restrictions upon the price maintenance system or upon the admission of retailers to certain trades were detrimental to the public interest. The Committee on Resale Price Maintenance, 1948, concluded that a single manufacturer should have the power to prescribe and enforce resale prices for his goods. Throughout, competition was held to be necessary in the public interest but it was thought that this would not be seriously restricted except by collective action.

The report on Collective Discrimination (June 1955) was the outcome of a reference to the Monopolies and Restrictive Practices Commission requiring it to report on the general effect on the public interest of specified practices that resulted from agreements between two or more persons carrying on business as suppliers of goods or processes. The Commission identified six categories of agreements and concluded that the general effect of each of them was that they operated against the public interest. The six categories were:

1 Collective discrimination by sellers (without any corresponding obligation on the buyers).

[Sir] Bernard Miller, Kt, is a member of the Economic Development Committee for the Distributive Trades, and he was a [me]mber of the Monopolies Commission, 1961-9.

2 Collective discrimination by sellers in return for exclusive buying.
3 Collective adoption by sellers of a policy of maintaining resale prices or imposing other collateral trading obligations on the buyers.
4 Collective discrimination by sellers to enforce resale prices or other contract terms.
5 Collective discrimination by buyers (without any corresponding obligation on the sellers).
6 Aggregated rebates.

It will be seen that only one of these, number 5, collective discrimination by buyers, relates to restrictive action at the wholesale or retail end of the trade as distinct from the manufacturing end, and on this category the report says 'The Commission have met no example of exclusive buying operated by itself', and went on to say 'whether used alone or not, it is essentially a powerful weapon in the hands of distributors, which is likely to be used to protect established traders in ways which are generally against the public interest.' Subsequent work of the Commission shows little, if any, evidence of the use of this category of collective discrimination by distributors.

This report led in due course to the Restrictive Trade Practices Act, 1956 which set up a Restrictive Practices Court requiring registration of all agreements between two or more persons covering prices and terms of the supply of goods or services. It specifically outlawed collective action to enforce retail prices by either witholding supplies, refusing fair terms or restricting supply. The Monopolies Commission was reconstructed with all these matters outside its future terms of reference.

Distributive aspect of the Commission's work

The work of the Commission in relation to distribution had always been primarily concerned with action by suppliers which limited competition among distributors. With the removal from its purview of collective agreements, it was concerned henceforward with the action of the holders of monopoly power as defined by the Act, and still primarily with manufacturers rather than distributors. Its work in the next ten years underlined the serious threat to competition in distribution that could arise from the use by single firm monopoly (or the holders of dominant market power) of the practices that had been made registrable when practised collectively or, in the case of the collective enforcement of resale price maintenance, condemned outright. The report on Wallpaper (1964) found that the extent of concentration of manufacturing in the hands of one group was reducing competition, with no benefit to the public, by its use of exclusive dealing, loyalty discounts and restriction of supply of certain qualities. It also looked at margins of profit as evidence of abuse of market power. The Report on the Distribution of Petrol (1965) was concerned with solus trading. This was held not to be against the public interest per se, but to be against the public interest in the way in which it was operated by means of long-term agreements, company owned stations, restriction of disposal of premises, exclusion of competitors' lubricating oils, etc. It underlined an effect of dominant market power that appears in subsequent references, namely that the dominant suppliers consistently sought to minimize price competition.

The Report on Colour Film (April 1966) found that Kodak had used its dominance of the market to maintain a pricing policy which produced very high profits for itself, high margins for its retail and wholesale distributors together with control of the channels of distribution and embracing restriction of certain processing of its own plants. It effectively prevented any real price competition amongst distributors. It was closely followed (August 1966) by the Report on Detergents which found a similar situation resulting from the policies of two suppliers who shared between them, almost equally, 90 per cent of the total market. They competed in everything but price, with the result that very high cost advertising put up the price to consumers and also the cost of entry for competing manufacturers. Neither company was therefore under pressure from third parties and working within comfortable, and in one case high, rates of profit, there was no pressure to reduce prices. These references indicated clearly that the main target of competition policy, in relation to distribution, must be the producers.

Objectives of a policy for distribution

Out of these Reports there emerges a picture of the Commission's view of what is required in the field of distribution to serve best the public interest. In the Colour Film Report it is: 'That the customer obtains good quality and efficient service at the lowest possible price consistent with a fair reward to the supplier.' In detergents it is that selling costs should not be unreasonably high and that competition should produce benefits to the public in prices and other ways. In petrol it says that the system must provide opportunities for distributors to earn a satisfactory return and goes on: 'The overriding interest is that of the general public . . . that in the distribution of these goods the national resources should be used as economically as possible and with the maximum regard for amenities, road safety and the avoidance of road congestion.' To sum up, the distributive system should thus ideally provide fair but not excessive rewards to both suppliers and distributors, should permit real competition, should see that the customer benefits from this competition by getting good quality and good service at the best possible price and should have regard to the most efficient use of national resources and the claims of society in respect of amenities and other social objectives. This provides a good definition of the objectives in distribution that any competition policy should seek to establish and a framework for considering whether there is need for further constraints upon distributors and, if so, what they should be.

Although in many cases established distributors have been willing collaborators in the restrictive practices of producers it will be clear from the survey of the Commission's work that collective action by distributors themselves has been very little in evidence. Now that the policy of producers to make and enforce restrictive practices has been greatly limited, so that in

effect it can now derive only from a monopoly situation, against which the Monopolies Commission is an effective machinery for action, is there a danger to the public interest from the willingness and/or ability of distributors to make and enforce restrictions themselves?

Characteristics of distribution

The prime issue here is what prospects there are of monopoly situations within distribution, that is to say the achievement of dominance of the market of which the use on the supply side has been responsible for so much of the restriction of competition in distribution. The particular characteristics of distribution mean that such dominance is unlikely to be a factor in competition policy.

The most obvious, and perhaps most important of these characteristics is ease of entry. Anyone can set up as a retail shopkeeper with little capital and no experience and great numbers of people do just that, and there are, and in my view always will be, plenty of newcomers to replace those who fall by the wayside. This country will probably continue to have more shops per head of the population than any other country. The extent to which the larger units will drive out the small and reduce competition to a level at which the consumer will suffer, is in my view clearly limited—the small shopkeepers' proportion of total retail trade will diminish but it will always be substantial. The Economic Development Committee for the Distributive Trades has recognised this and much of its work has been directed towards helping the small retailers to increase their efficiency.

A strong influence in the same direction comes from another particular feature of distribution, the very wide range of different kinds of demand that enables many different kinds of supply to be viable. Almost every permutation of degrees of cheapness, service, quality, exclusiveness, etc., will, if efficiently supplied, meet a viable demand, and the rate at which new [illegible] brings continual change in methods and techniques at all levels of size that are a constant threat to established distributors, and size will not enable the inefficient to keep their place.

A further result of the changing nature of the product and the extent to which its value to the customer is subjective, depending on his or her preferences between value, service etc., is that the line at which the economies of scale cease to grow is probably much lower relatively than in manufacturing industry. It varies with different kinds of distribution, but even in such fields as the relatively standardized supermarket chains, it is well below the size of a number of the biggest groups. Much of the growth at this level brings more profit to the entrepreneur but little benefit to the consumer.

Finally, both rates of return upon capital and the average level of wages in the distributive trades are well below the general levels in manufacturing industry. This was notwithstanding the fact that it is a pretty high risk business and for the workers it is hard work, involving for many of them good levels of skill and knowledge, and hours of work that do not compare well with those generally available elsewhere. These conditions suggest that the distributive industry is not one in which the interests of the customer are sacrificed either to the interest of those who provide the capital or the labour, neither of which can be easily obtained in this industry.

In no area of distribution has concentration come within sight of market dominance. It might have been thought to arise in the Burton/United Drapery Stores merger reference but the Commission rejected the merger on the grounds of concentration of control in the supply of woollen cloth and did not find any prospective monopoly position in the retail shops involved. It might be thought to arise from the concentration of the wholesale textile distributors under the Courtauld umbrella, but this is mainly the channel of supply to smaller retailers and is fully countered by the direct buying of large groups. I cannot claim any authority based on comprehensive research or analysis but from the nature of the distributive trade I see no prospect of any monopoly development.

Issues for policy in distribution

As I see it, the chief issues in competition policy in regard to distribution are likely to arise from the incompatibility of some of the objectives of the ideal distributive system summarized above. In particular there is a basic conflict between productivity, the most efficient use of national resources, on the one side, and the wishes of the consumer, real or putative, on the other. Sir Hugh Weeks has touched on this in his paper, pointing out that the wishes of customers, expressed through surveys, the Consumer Council, the Consumers Association and other bodies can only be met by a high-cost distribution system, and American experience has demonstrated this very fully.

It can be argued that if competition is given its head all shops will end up with overlong hours of opening and all of the emphasis will be on sales promotion gimmicks, heavy advertising, gift packs, trading stamps, etc., that do in fact militate against the customer getting 'good quality and good service at the best possible price'. There is a case for the view that the real interest of the consumer requires some constraint upon unlimited competition, for example the development of trading stamps a year or two ago was met by a movement against them which secured some restrictive legislation. But the event has shown that the judgment of the market has been a better control. Some consumers, particularly in areas such as petrol, prefer stamps to price reductions, but generally speaking the majority of them have voted solidly the other way for most of their expenditure.

Similarly with hours of shopping. Freedom to work on six days a week has developed in the last two years and there is now a great diversity of shopping week with some shops opening five days, some five and a half and some six days and also a great variety in late opening. Five day opening means greater efficiency for certain types of distribution and t[illegible]

indication that it cannot compete fully with the six day opening of other kinds of trading. There is little evidence that the Shops' Act restriction on hours of opening is more than a marginal restriction on the customer's choice. From the standpoint of trading policies it could well be removed, although there may be substantial considerations against this in respect of the labour market and the natural concern of the unions for the conditions of work of their members.

In its report on Detergents, the Monopolies Commission recommended limitation of the very extravagant advertising expenditure and action was taken to secure the marketing of some products at a lower cost with much reduced expenditure upon advertising. The outcome in terms of customer benefit has been obscure, but what was abundantly clear was the difficulty of controlling the market practices of firms in this way. Here again in retail distribution the verdict of the market makes itself known. The most successful groups among variety stores, department stores and supermarkets advertise hardly at all, and rely for their success upon concentrating on giving customers good quality and good service at the best possible price.

All this and much other similar evidence against the need for any policy or machinery to increase competition in distribution is reinforced by considering the effects of the parallel development of large groups both in the manufacture and the distribution of consumer goods, and in particular the position of the small trader in this picture. These large groups make possible much more efficient use of resources, with, in consequence, greater productivity and better quality and design in the goods. But these benefits reach the hands of consumers by means of quantity discounts, exclusive dealing, house brands and other commissioned production. These advantages can be very great and could provide margins that could be used to serve the interests of the supplier and the distributor more than those of the consumer. The strength of competition at the distribution end will in my view always limit this pretty narrowly and secure that the consumer gets a large share of the benefit.

Position and prospects of small trader

This emergence of large-scale distribution to match large-scale supply makes life very difficult for the smaller trader and raises the question of whether competition policy should not go further to protect the smaller trader than it does already. Indeed, as Sir Hugh Weeks' paper brings out, some of the existing machinery to prevent restriction of competition operates to restrict the ability of small traders to compete with the large groups. But experience in other countries and the facts in our own underline the difficulty of devising machinery to protect the small traders that may not operate in the interests of the traders rather than the consumers. An example of this dilemma is the Monopolies Commission reference on Recommended Prices. A large part of the case for retaining them was in the benefit to the small shopkeeper in pricing and handling his merchandise, and it was accepted by the Commission as ground for retaining recommended prices. But the danger that recommended prices could in effect come close to being maintained prices was recognized by the Commission to be very real and to require the provision of means to deal with cases where they were going to work in that way.

Measures for the specific protection of the small shopkeeper may well work against the consumer in other ways, such as by limiting the benefits of large-scale operation. Attempts to limit quantity discount or exclusive dealing would restrict distributors' competition also against the national brand manufacturers. These latter build up national demand by heavy selling expenditure so as to create pressure upon distributors to give them display and selling space. This can easily work to the detriment of the consumer, as the Monopolies Commission found, and the distributors' chief weapon against this is in own brand production based on quantity discount and exclusive dealing, which generally provides the consumer with better value in what is often an identical product. Any legislation on the lines of Robinson-Patman in America might well greatly restrict the ability of Marks & Spencer to provide the value they do. Professor Almarin Phillips' paper on the contribution of anti-trust gives several examples of the way in which anti-trust legislation in America has promoted the interests of distributors above that of consumers.

Monopsony

Sir Hugh Weeks fears that monopsony is a possible danger, that is to say the growth of the power of large buyers *limiting the competitive power of manufacturing*. In my view the growth of buying power on the distributive end is much more likely to produce greater competition in manufacturing industry. The strength of the larger manufacturers of some products is very great and smaller manufacturers' ability to compete will be strengthened by the orders which large distributors can place with them to provide merchandise competitive with that of the large manufacturers. Moreover there is nothing new in large-scale buying. It has been operated by some of the more successful large groups since before the war. It was in fact largely the weapon by which in the food trade resale price maintenance was broken down before the legislation in 1964; the chief pressure for abolition of resale price maintenance came from parts of the distributive trades. It is perhaps more exact to say that competitiveness in distribution was a major influence on the ending of resale price maintenance than the converse.

Summary

This paper seems to have developed into an *apologia* for distribution. It did not set out to be one, but to distil from my own experience facts and opinions bearing upon competition policy as it affects distribution in this country. I speak, of course, as a large-scale distributor and there will be other views on the points I have made, for which the following summary can perhaps provide a focus.

1 The work of the Monopolies Commission has done much to increase competition in distribution.
2 It has done so mainly in remedying constraints upon competition at the manufacturing end and its work has shown little evidence of restriction at the distributive end.
3 The nature of the distributive trade makes it unlikely that centres of market dominance will develop so as to require legislative action to preserve competition. Competition is strong enough to make the consumer's voice effective.
4 There is some conflict between the objective that distribution shall aim at the optimum use of national resources and its other objective of meeting customers' wishes to the maximum extent.
5 Any further machinery for the protection of small traders may well work against the interest of the consumer.
6 The efficient small trader will survive anyway.

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5·4 Some aspects of Canadian policy relating to distribution

L A Skeoch

The division of this conference into a number of separate sections is based, I would assume, more on considerations of orderliness and the potential advantages of specialization than on a belief that the different sections are logically separable and functionally distinct. Certainly, the distribution sector both influences and is influenced by conditions prevailing in the manufacturing and processing industries. Integration and alteration of function in the customary manufacturer–wholesaler–retailer chain is shifting the locus of decision-making in uncertain ways. Sometimes the large retailer extends his influence backwards into all aspects of manufacturing; sometimes the manufacturer or wholesaler reaches into or over the retail sector, and so on. The smaller firms tend to feel the effects of such changes in greatest measure, although this is not invariable.[1] Oligopoly in manufacturing, if closely co-ordinated, may encourage forward integration by merger or new investment into distribution in order to limit the scope for independent behaviour in that sector and the competitive pressures thus generated. These tendencies are sufficiently familiar to require no further comment.

The distribution sector is thus dependent for effective performance not only on those public policies that are traditionally regarded as relevant to distribution but also on the more general policies designed to maintain a competitive, adaptable economy.

To put it differently, the best designed and implemented policies in the distribution sector can be devitalized—even effectively neutralized—by poorly designed or administered policies in other sectors. These may relate to mergers, monopolies, direct government controls, the lack of adequate policies to aid and speed the process of economic adjustment, and so on through a lengthy list. Considerations of this nature, I believe, often account for the disappointing results flowing from, say, the banning of resale price maintenance. Ambivalence and confusion often triumph over coherence and consistency.

We, in Canada, sometimes credit ourselves with special shrewdness in being able to detect the need for legislation in the area of restraints on competition, and, in a purely calendar sense, there may be some evidence to comfort us in this view.

As early as 1888, A Select Committee of the Canadian House of Commons undertook a broad investigation into a number of trades in which it was suspected that competition was being restricted to an excessive degree. The Committee's report found that combinations inimical to the public interest did exist, and recommended that legislative action be taken to curb such restraints. Incidentally, the report contained a sophisticated discussion of resale price maintenance which resulted in a lively controversy with Professor W J Ashley over the 'loss-leader' issue.[2]

Agreements in restraint of trade

In 1889, a year before the Sherman Act was passed in the United States, the recommendation of this committee was adopted and an Act[3] of very broad scope was passed prohibiting conspiracies, agreements or arrangements in the production or sale of any article or commodity which was the subject of trade or commerce, 'or in the price of insurance upon persons or property'. Although not without some effect, the legislation failed to provide for administrative machinery to secure evidence, and it remained for some years largely a statement of purpose devoid of controlling influence on the developing economy. It was only in 1923 that this gap was effectively closed, and although for some decades the resources provided for enforcement were seriously inadequate, it can be said that from that time forward agreements to fix prices or divide markets have been pursued with vigour and persistence. That they still occur—and occasionally recur—is due primarily to the limited

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1 For a more detailed discussion of some of these developments, see, e.g. M S Moyer and G Snyder, *Trends in Canadian Marketing* (Ottawa: The Queen's Printer, 1967). 'As the market struggle proceeds, it appears that responsibility for performance of the buying function is passing out of the hands of the small retailer and perhaps the wholesaler and into the hands of the large retailer and the large manufacturer' (p. 23). 'Price-setting has been partly shifted to the wholesaling and manufacturing levels' (p. 24). 'Thus, in the marketing of both durables and nondurables, the technology of modern communications media has tended to favour the transfer of some of the selling function from the retailer to the manufacturer and his agents' (p. 26).

2 For further discussion of this incident, see L A Skeoch, 'Resale Price Maintenance—Canada' in B S Yamey (ed.) *Resale Price Maintenance* (London, 1966), pp. 25–7.

3 *An Act for the Prevention and Suppression of Combinations formed in Restraint of Trade.* sc 1889, C.41.

impact of the penalties imposed. Indeed, the generally high effectiveness of combines policy in this area has undoubtedly shifted the efforts of those seeking to abate the rigours of competition to other devices, such as resale price maintenance, mergers and price discrimination.

Mergers

[illegible] detriment or against the interest of the public. This, it will be recalled, was four years before the enactment of Section 7 of the Clayton Act, with its limited merger coverage.

However, here our Hamlet-like irresolution towards the more complex restraints on competition began to manifest itself. Having completed effective analysis and its embodiment in legislation, self-doubt intervened and it was not until a half century later that the first full-fledged Canadian merger case was proceeded with — and it was lost. Nor has the situation been altered to the present. Although an economy of moderate to small size must pursue a more cautious and sophisticated merger policy than a large economy — where one merger more or less is unlikely to be of strategic importance — it is scarcely credible that over a period of sixty years not a single merger in Canada operated to the public detriment. A highly persuasive case can be made for the view that Canada's impotent enforcement of its anti-merger legislation has thrown a heavier burden on other sections of its anti-combines policy, if, indeed, it has not effectively circumvented that policy in some industries.

Price discrimination

Legislation on price discrimination — departing from [illegible] by the US Congress.

In substance, the price discrimination section prohibited three things: discriminatory price concessions among competitors who buy like quantities and qualities of goods at the same time; geographical or regional price discrimination which substantially lessens competition or eliminates a competitor, and the selling of goods at 'unreasonably low' prices which substantially lessens competition or eliminates a competitor. In 1952, the section was amended to make it clear that 'the discriminatory price concessions among competitors' related to 'a practice of discriminating' and did not prevent a supplier from meeting spot competition from another supplier offering a better price to a customer. In 1960, a further amendment required that promotional or advertising allowances be 'offered on proportionate terms to other purchasers in competition with the first-mentioned purchaser'.

Although one may have reservations about the adequacy of the approach adopted by this legislation,[4] it is difficult to assess the impact of its terms when there has been virtually no enforcement over the period of more than three decades since its passage. The limited action taken by the combines authorities has amounted to three investigations and reports (1961) by the Restrictive Trade Practices Commission relating to the marketing of gasoline in the city of Toronto, in two of which legal proceedings were recommended but not undertaken, and two Commission reports (1962 and 1964) resulting in legal proceedings relating to the marketing of evaporated and fresh fluid milk.

It is worth noting that the two general areas involved (the marketing of gasoline and of milk) are tight oligopolies selling essentially homogeneous products, in which concentration has been substantially increased by merger activity in recent years.[5]

Such situations — even if the mergers are justified by real-cost advantages or longer-run dynamic considerations (neither of which has been demonstrated in these cases) — give rise to complex issues for policy. Prices may be more readily set by collusion,[6] which, at the least, requires increased investigation by the government agency. Prices may be set simply by mutual awareness of the instability which will result from independent pricing behaviour, a form of conduct which cannot realistically be attacked. Secret rebates and discounts, which sooner or later put pressure on price structures, may reflect superior efficiency on the part of the firms granting them but may be regarded as less aggressive than open price cuts, or they may represent disciplinary action against smaller rivals or new entrants. In either case, they may be attacked as being discriminatory under the legislation. Open price cuts — often called price wars — may be a test of competitive strength, or they may again be used as disciplinary devices. To maintain pressure on costs and prices in tight oligopolies but to restrain predatory behaviour should be the aim of policy, however, to distinguish between these situations requires highly sophisticated analysis, as Adelman has so brilliantly demonstrated.[7]

4 For a discussion of some of the problem aspects of the legislation, see *Discriminatory Pricing Practices in the Grocery Trade*, Ottawa: The Queen's Printer, 1958, esp. pp. 5–8, 211–20.

5 For information on the facts relating to one major market area, see Duncan Allen, 'Concentration and Competition in Ontario's Fluid Milk Industry', *Ontario Economic Review*, Vol. 3, No. 7, pp. 3–14. Allen reports that ninety-three mergers and absorptions occurred over the period 1945–65. His discussion of the effects of these mergers on competition is carried out in a framework that concentrates unduly on the short-run aspects of industry behaviour.

6 An investigation by the combines authorities found that in 1954 Toronto dairies refused to submit competitive tenders for hospital milk accounts. In 1959, a further investigation indicated that the provincial Dairy Commission convened meetings with Toronto distributors at which efforts were made to eliminate all discounts and rebates at the wholesale level and to encourage the maintenance of minimum retail selling prices. Since the situations 'had corrected themselves', no formal proceedings were initiated. In view of the anti-competitive record of the industry, it would seem that a formal order prohibiting the repetition of such conduct would have been appropriate.

7 See M A Adelman, *A & P: A Study in [illegible] Public Policy*, Cambridge, Mass., 1959.

It cannot be said that the limited number of cases initiated by the combines authorities have displayed such sophistication. The three Commission reports dealing with the distribution of gasoline in the city of Toronto did not result in legal action—although it was recommended by the Commission in two cases—and hence may be considered to have little influence on business behaviour. The function of the Commission—as it too often forgets—is not to serve as a preliminary court but to provide analyses of market situations which may have detrimental consequences, whatever their present legal status may be. In this sense, its reports are expected to inform and guide public opinion and policy. Hence, its analysis of the Toronto gasoline cases merits at least brief comment.

A careful analysis of the three reports led Clarke to the following conclusions:

The function of the public authority in such instances should be to sanction those forms of price discrimination which promote competition and to recommend the cessation of discriminatory practices which are restrictive. It must be concluded that the Restrictive Trade Practices Commission has not fulfilled its function. The Commission has declared possibly beneficial forms of price discrimination illegal, while sanctioning other forms of the practice which may have deleterious competitive consequences. . . .

The complexities of the industry and the ambivalent nature of price discrimination demand sophisticated economic analysis if competition is to be promoted. The Restrictive Trade Practices Commission should be prepared to employ a much more thorough analysis of the implications of price discrimination than was apparent in the reports examined, and the effects of price discrimination upon competition, rather than its effects upon competitors, should be emphasized.[8]

The two milk cases in which illegal price discrimination was alleged by the Commission and in which charges were laid may also be considered of limited importance since in both cases the courts registered acquittals. They do, however, provide some limited indication of the views of the combines authorities and the courts as to the interpretation of the legislation.

The facts of the Ottawa milk case are briefly as follows: there are five main distributors of milk in the city, two being subsidiaries of national organizations. The practice had developed with the chain supermarkets that when a new store was opened the milk distributor would usually sell the milk to the new store at half price or less so that for the first few days of operation special prices could be offered to customers. Such an arrangement was made on 15 November by one of the local dairies to come into effect on 16 November. Another local dairy then made arrangements of a similar kind with one of the chain supermarkets which was not, however, opening any new stores. The two national dairies then extended similar price reductions to all their wholesale customers. This condition existed from 16 November 1961, until 18 November 1961, at which time a meeting of representatives of the dairies was held, later to be joined by representatives of the union of door-to-door delivery men who threatened to refuse to work unless the low wholesale prices were withdrawn. As a result of these meetings the low prices were withdrawn and conditions returned to 'normal'.

A charge was laid against one of the national dairies, charging it with the offence of selling goods at 'unreasonably low' prices which substantially lessens competition or eliminates a competitor. The charge was dismissed with the comment:

Surely it was never intended by the Section that the dislocation of business for a two-day period which had very little effect on competition would be considered an offerce under this Section.

It should be added that, even if the conduct had resulted in the lessening of competition or the elimination of a competitor, public policy cannot accept the termination of such conduct by the sort of collusive action adopted in this instance. On the whole, this was a most unfortunate proceeding whose significance will not be missed by other groups interested in self-regulation of industry.

The evaporated milk case involved a charge of regional discriminatory pricing having the effect of substantially lessening competition or eliminating a competitor. Three firms were engaged in the processing and marketing of evaporated milk in the relevant markets: two (Alpha and Pacific) were regional firms centred in the provinces of Alberta and British Columbia; the third firm (Carnation) was a national, in fact, an international, organization. Carnation was charged with selling milk in Alberta and British Columbia during the period December 1959 to August 1960 at lower prices than in the province of Ontario with the consequences specified above.

The three firms had been engaged in the evaporated milk trade for some years, open price competition was non-existent, competition taking the form of advertising allowances, secret discounts, drop shipments and the like. Alpha enjoyed particular success in the province of Alberta where, between 1956 and 1959, it succeeded in reducing Carnation's share of the market from 50 per cent to 20 per cent. In 1959, Alpha decided to expand its sales in British Columbia, where it enjoyed only a small market share. Its promotional efforts in this area set off a series of moves and countermoves involving price reductions as well, with Carnation and Alpha being the major protagonists. Discussions among the three firms—although, to quote the majority decision of the Appeal Court, 'They seem to have carefully kept away from a discussion of prices'—began shortly after the 'price war' broke out, and by March 1960, prices were back to 'normal'.

Shortly thereafter, Alpha made a complaint against Carnation to the Director under the Combines Investigation Act, and on 11 October 1966 Carnation was charged with the offence already set out. Carnation admittedly sold its milk in Alberta and British Columbia at less than its price in Ontario, and the question for the Court was whether this action was designed to lessen competition or eliminate a competitor, or simply to meet competition. The Court decided in favour of the latter interpretation. At the same time, in commenting on the delay of more than six years between the complaint of Alpha and the laying of the charge against Carnation, the Court raised a highly relevant question:

8 Stephen Glenn Clarke, *Public Policy and the Retail Distribution of Gasoline* (MA thesis, Queen's University, 1964), prepared under the supervision of the present writer.

One may well wonder, in the light of the evidence adduced at the trial, if some of the time may not have been taken up by a consideration by the Department of the possibility of proceeding against all these participants under another section of the Code which, it seems, might well have been considered applicable to the circumstances.

Two things stand out in the milk cases. First, the excessive sensitiveness of the combines authorities in interpreting the extent to which competition can be substantially lessened or a competitor eliminated. Certainly, in these two cases, nothing much more than competitive skirmishes were engaged in. If this view is persisted in, then, despite the courts' rulings, anything resembling 'hard' competition will be effectively restrained. Second, the willingness to overlook the open or tacit collusion involved in restoring oligopolistic co-ordination on pricing and other aspects of market relationships creates serious problems for maintaining that level of uncertainty that separates oligopoly from monopoly.

Resale price maintenance*

[illegible]

and all-inclusive. However, a qualification of serious potential significance was admitted, almost casually, during the committee stage of the bill when the responsible Minister, in response to a question, stated that suggested resale prices would be permitted, provided that nothing was done to enforce them. No reference to this qualification was included in the legislation.

The policy of specifying resale prices, often without the qualification that they are suggested, is very widespread. Its precise impact is not easy to determine. In a recent study of marketing in Canada, Moyer and Snyder remarked with reference to suggested retail prices, 'These prices are not binding, but there can be no question that they are determinative. It seems safe to conclude that price-making does not occupy the retailer as it did.'[10]

This is an overstatement. In the circumstances of some trades—books, more expensive jewellery, gasoline and motor oils, a considerable portion of drug products, hardware and electrical appliances (for special reasons to be discussed)—the observance of suggested resale prices is undoubtedly high. The factors accounting for this situation appear to vary from trade to trade: in some, the nature of the demand for the product may be important (perhaps, books); in some, professional cohesiveness supported by strong trade association activity (drug-store products and jewellery); in some, the convenience of pricing thousands of small items (hardware, although trade association activity is also important here); and in some, tight oligopoly among suppliers (electrical appliances, although here legislation relating to loss-leader selling—to be discussed—is important; and gasoline and oil, where price discrimination is used as a disciplinary device, supported recently by consignment selling).

At the same time, specifying resale prices can become a two-edged sword since it provides the opportunity for the discount seller to dramatize the magnitude of his price cuts. Indeed, for some years after the ban on resale price maintenance became

[illegible]

...alleging that such selling amounted to the widespread use of 'loss-leaders' were rife, an exhaustive inquiry conducted by the Combines Branch and the Restrictive Trade Practices Commission concluded that 'the evidence does not suggest in any way that selling of this sort is a practice in any line of trade, even among a minority of the dealers'.[11]

Nevertheless, with the change in government in 1957, the Conservatives who had strenuously opposed the ban on resale price maintenance in 1951, responded sympathetically to the complaints and in 1960 amended the section prohibiting resale price maintenance by providing a defence against a charge of practising resale price maintenance. The substance of the amendment was that no inference unfavourable to a person charged under the section would be drawn 'if he satisfies the court that he and anyone upon whose report he depended had reasonable cause to believe and did believe' that the other person was making a practice of using articles supplied by the person charged as loss-leaders. Loss-leaders were defined, vaguely, as being sales made 'not for the purpose of making a profit thereon but for the purposes of advertising', and 'not for the purpose of selling such articles at a profit but for the purpose of attracting customers to his store in the hope of selling them other articles', which amounts to much the same thing as the first definition.

In practice, this means that a dealer who sells a product below the suggested resale price must be prepared to prove, not that he is selling the product above his laid-in cost, but above his laid-in cost plus his cost of selling *that item* so that the sale yields him a profit. If the supplier has 'reasonable cause to believe' that this is not being done, he may refuse to supply the dealer with the product. The basic assumption underlying this amendment is that dealers can and should compute costs and profits for each individual item in their array of goods. Rarely can this be done, since distribution cost accounting is simply not equal to the task, nor should it be done unless we adopt the odd view that 'costs' justify prices in the short run.

* It is not possible within the scope of this article to review comprehensively Canadian experience with the banning of resale price maintenance. A more complete analysis is available in the section on Canada prepared by the writer in B S Yamey (ed.), *Resale Price Maintenance*, pp. 23-64. Some more recent material is included in the present paper.

10 M S Moyer and G Snyder, *Trends in Canadian Marketing*, Ottawa: Dominion Bureau of Statistics, 1967, p. 24.

11 For a more complete discussion cf Yamey (ed.), op. cit., pp. 41-[illegible]

The jurisprudence up to the present[12] does nothing to allay the fears of those who opposed the enactment of the section. It apparently holds that a supplier, in this case Sunbeam Corporation (Canada) Limited, could not use its list of minimum profitable resale prices, incorporating a mark-up calculated from a survey of the costs and profits of a group of dealers which it considered to be efficient, as a basis to persuade dealers to observe such prices, but only as 'notification to the dealer of the area of resale price at which the retailer must be regarded by Sunbeam as loss-leading the article in question'.[13] In this latter situation, Sunbeam could then, presumably, refuse to supply the offending dealer. Where suppliers are few or control the most popular consumer brands, this is, of course, a powerful sanction.

Price-making can, in this way, be taken out of the hands of the individual dealer to a significant degree. The consequences of this development could be serious for dynamic change. The dealer who may develop new techniques of distribution which permit him to operate profitably at less than the mark-up of existing 'efficient' dealers, will find one more road block in his path. Innovation is always difficult; only evidence of genuine inequities resulting from the original resale price maintenance legislation—which the most searching investigation failed to uncover—would justify the erection of this additional impediment.

Thus, the original legislation banning resale price maintenance has been circumscribed and diverted, in some degree, from its purpose of promoting competitive efficiency. However, the constraints appear to be effective only in certain trades. The loss-leading defence against a charge of resale price maintenance has had its greatest impact in the marketing of electrical appliances.[14] The drug-store trade, once the bastion of resale price maintenance, has within the past few years experienced the incursion, especially in the larger urban centres, of chains or individual units of discount drug stores. Information provided to the writer by a number of such stores indicates that they have not, as yet, encountered difficulties in obtaining supplies based on the loss-leading section. Since almost all products in this trade carry suggested resale prices, these stores are able to dramatize the extent of their reductions by showing on their price tickets both the suggested and the discount price, a technique that cannot now be employed by the discount appliance dealer to the same extent. How far the more permissive drug-store situation can be accounted for by the public inquiries into drug prices, carried out recently by the Combines Branch and a Parliamentary Committee, is matter for speculation, but they very probably have had some influence.

It seems safe to conclude that amendments, both formal and informal, have blunted the edge of the ban on resale price maintenance. It is, however, difficult to measure the magnitude of these effects, and to distinguish them from the consequences that may flow from ineffective policies relating to mergers, price discrimination and the like.

The effect of banning resale price maintenance on distributive margins[15]

In attempting to assess the impact of the abolition of resale price maintenance, one of the indicators that is most readily available is the gross distributive margin for the individual trades affected, the reasoning being that if resale price maintenance tends to expand margins, its abolition should tend to narrow them at least relative to margins in trades where resale price maintenance has not been employed. Taken by itself, such a comparison would have to be used with caution,[16] but as part of a more general analysis, it undoubtedly possesses some evidentiary value.

In an earlier study, the writer compared the gross margins for the five trades[17] in which resale price maintenance was important before 28 December 1951, with the margins for eight trades[18] in which price maintenance was of minor importance for the period 1950–1 and 1956–7.[19] It was found that gross margins in the former price-maintained trades had increased by only about 1 per cent, whereas in the former non-price-maintained trades they had increased by about 10 per cent. That is, the data were consistent with the view that competitive pressures released by the banning of resale price maintenance had effectively restrained the rise in gross margins as compared with the behaviour of margins in trades in the other category.

A similar calculation was made for the same two categories of trades for the period 1964–6 as compared with 1956–7. The results are as shown in the accompanying table.

Increase in average gross margins

	1956–7 over 1950–1	*1964–6 over 1956–7*
Former resale price maintenance trades	1·0 per cent	4·0 per cent
Non-resale price maintenance trades	10·0 per cent	3·9 per cent

12 The major case is *Regina v. Sunbeam Corporation (Canada) Limited*, Supreme Court of Ontario, 18 March 1966.
13 Quoted from the judgement.
14 It is worth noting that a spokesman for the Canadian Electrical Manufacturers Association, giving evidence before the Standing Committee on Banking and Commerce, in 1960, testified that 'virtually all' electrical manufactured goods were assigned suggested resale prices by manufacturers, and that taking account of all electrical goods sold through middlemen, between 60 and 75 per cent of such goods were sold at prices suggested by the manufacturers. The proportion would now presumably be somewhat higher, particularly if minimum profitable resale prices are taken as the bench-mark.

15 For a more detailed discussion of this topic, see Yamey (ed.), op. cit., pp. 53–7. The data quoted in this section for the period 1950–1 to 1956–7 are taken from this source.
16 For some of the qualifications, see *ibid.*
17 The five trades were: confectionery and tobacco, hardware, radio and electrical, drug stores and jewellery. Resale price maintenance was also important in the book trade but gross margins were not available for it.
18 The eight trades were: combination stores (meat and groceries), meat, fruit and vegetables, men's clothing, women's clothing, footwear, furniture, variety stores.
19 Such statistics were available for Canada only on a biennial basis, making it necessary to employ two years to cover the trades included. More recently, gross margins have been calculated only on a triennial basis. The margin data are reported by the Dominion Bureau of Statistics.

From these rough calculations, it would appear that the effect of banning resale price maintenance had substantially worked itself out during the first period (1950–1 to 1956–7), and that during the second period both categories of trades responded in much the same way to the prevailing market influences. There is much to be said for this interpretation. Sooner or later, the scope for absorbing cost increases which would be assumed to exist where resale price maintenance made possible inflated margins, would be dissipated when the practice was banned.

At the same time, there are some interesting aspects of the behaviour of individual trades which may merit brief comment. Of the five trades in the former price maintained category, one, confectionery and tobacco displayed an actual decline in its gross margin from 18·98 per cent in 1956–7 to 17·09 per cent in 1964–6, which, in turn, was below the margin of 17 90 per cent in 1950–1. The pressure of competition in the sale of tobacco products, as other trades invaded this attractive area, no doubt accounted for much of the decline in this trade.

The drug trade presents a mixed picture. Independent, unincorporated drug stores showed a decline in margin from 31·2 per cent in 1950–1 to 30·26 per cent in 1956–7, followed by an increase to 32 68 per cent in 1964–6. Drug chains, however, showed a rise from 33 74 per cent in 1950–1 to 34·36 per cent in 1956–7, followed by a rather sharp decline to 33·08 per cent in 1964–6. It is at least plausible to suggest that this decline was associated with the expansion of chains of discount drug stores.

Perhaps the most interesting pattern of margin changes is displayed by radio and electrical appliance stores. Margins here fell from 27 8 per cent in 1950–1 to 25 62 per cent in 1956–7, followed by an abrupt increase of almost 18 per cent to 30 16 per cent in 1964–6. It is persuasive to consider that the loss-leading defence enacted in 1960 played a significant role in accounting for this increase. Were this trade to be omitted from the calculations, the former price-maintained trades would show an average increase in gross margin from 1956–7 to 1964–6 of only about 1 6 per cent.

Turning to the former non-price-maintained trades, most of the trades, with one exception, showed only mall increases, with two—independent furniture tores and chain variety stores—showing slight ecreases. The one exception is, however, of un-pected magnitude: margins for incorporated chain nbination food stores (primarily supermarkets) rose m 15 8 per cent in 1950–1, to 17 44 per cent in 56–7, and then to 21·33 per cent in 1964–6; that is, ncrease in the latter period of more than 22 per

nly exhaustive analysis would identify with con-ce the factors responsible for this variant be-ur, particularly when independent combination showed an increase of only about 6 per cent in margin for the period 1956–7 to 1964–6. How-ere are a number of circumstances peculiar to n supermarkets that may account, in whole or the outcome. The chains have experienced an ly rapid rate of growth, both absolutely and in their share of the market, since 1951,[20] a condition not ordinarily conducive to close cost control. The chains were involved in extensive merger activity, both horizontal and vertical, during the same period.[21] There are also suggestions that substantial excess capacity has been installed, particularly in shopping centres.[22] Professor Malcolm McNair's 'wheel of retailing' concept, in which retailers shift from a strong price competition approach to a high-cost, high-price type of operation, may also be relevant to this trade, particularly as tight oligopoly structures emerge.[23] New entry is also undoubtedly becoming more difficult. But, whatever the strategic factors may be in accounting for the rise in the average gross margin, it is clear that the absence of resale price maintenance has not been capable of bringing the rise under control, as its more enthusiastic proponents were inclined to believe.[24]

Conclusion

The contribution that public policy can make to improving the competitive efficiency of the distribution sector is dependent on developing a coherent and internally consistent approach involving both those policies primarily concerned with distribution (such as resale price maintenance) and those policies which influence the environmental conditions within which the distribution sector functions (such as mergers and price discrimination). In Canada, the latter group of policies has been handled poorly.

This has meant that far too heavy a part of the burden of adjustment has been thrown on policy in the distribution sector. The effective banning of resale price maintenance is, in my view, an essential element in maintaining competitive efficiency in the economy. This is so not only for its contribution to efficiency in distribution but because it can transmit pressure back to the manufacturing and processing sectors for reduced prices and costs. However, if mergers are permitted in these sectors which are not warranted by real-cost, dynamic considerations, or if tight oligopolies are permitted to employ discriminatory pricing practices which support established methods of distribution and discourage innovations, the potential

[20] Nationally, their share of sales rose from 32 3 per cent of total sales in 1951, to 47·2 per cent in 1964. The rate of increase was much higher in the large urban centres.

[21] See the *Proceedings* of the Special Joint Committee of the Senate and House of Commons on Consumer Credit (Prices), 1966–7, for details of the mergers in this area.

[22] *Ibid.*

[23] The evidence of the supermarket executives before the Special Committee was not without its credibility-gap aspects. When questioned about the costs of stamp plans and other types of promotional selling when each firm duplicated the schemes of the others, the executives insisted that such schemes actually reduced operating costs through their effects in achieving increased volume of sales. By the summer of 1968, all the supermarket chains had abandoned these arrangements on the ground that they increased costs by 1½ to 2 per cent.

[24] One of the reasons put forward by a former Commissioner under the Combines Investigation Act for banning resale price maintenance was that, although the number of price-maintained articles sold through grocery stores was small, it was increasing and was tending to raise the average gross margin. See Yamey (ed.) *op. cit.*, pp. 30–1.

contribution of a ban on resale price maintenance is seriously limited.

In a democratic society, the demonstration effect of ineffective policy with respect to the environmental factors, when combined with the neo-mercantilistic policies adopted by government in the production and marketing of many agricultural products, makes the task of maintaining competitive efficiency in the distribution sector peculiarly difficult. Amendments to the legislation to soften the impact of the process of adjustment become politically attractive. John R Commons, the great American economist of group economic action remarked '. . . log-rolling may be said to be the democratic process of agreeing upon the rationing of economic burdens and benefits . . . The process is universal; the purpose may be good or bad'.[25] In this process, the consumer is, unfortunately, too often the forgotten man.

Canadian experience has, I believe, clearly demonstrated that even inadequate policies in the distribution sector can make a worthwhile contribution to efficiency. It also demonstrates that a broader, more sophisticated approach to restraints in the economy at large is essential if even these limited gains are to be maintained.

It seems doubtful, however, that even competent enforcement of adequate legislation of the customary prohibitory type will serve the future needs—particularly of the smaller economies—for policy to promote efficiency, adaptability and dynamic change. *Prohibitory rules are necessary; they are becoming* increasingly insufficient to achieve these ends in the face of growing monopolistic forces in labour, industry, agriculture, distribution and the professions. The smaller economies—and those larger economies affected by long-standing rigidities—must devise positive programmes to assist and promote the processes of adaptation and change. So far, with a few notable exceptions, government policy has tended to support established patterns of economic behaviour and performance, rather than accept a substantial share of the social costs involved in economic change and establish conditions that promote, even require, adjustment to such change. Policy relating to restrictive practices can continue its primary concern with prohibitory rules only by becoming less and less relevant to the needs of emerging economic and social conditions. To restore the traditional functions of the market requires imaginative and new policy initiatives.

25 *Institutional Economics*, New York, 1934, pp. 755-6.

5·5 Food retailing: a case study of United States anti-trust policy toward the distributive trades

Mary Gardiner Jones*

I Introduction

United States anti-trust policy is basically designed to assure that the sectors of the economy to which it relates conform to certain socially desirable economic goals: competition, and all that it implies for optimum efficient resource allocation and consumer prices which are as low as possible relative to production costs; on-going technology and product innovation, a continued equitable share in economic participation for the independent business man, and a fair return for investors.

Implementation of anti-trust policy has always been characterized by a mixture of rules, some such as laws governing mergers, corporate interlocks and monopolization which are aimed primarily at preserving the structural conditions of competition, and others such as laws relating to price fixing, resale price maintenance, exclusive dealing and tying contracts, price discrimination and predatory price and non-price conduct which work directly on industry behavior in order to achieve the goals of anti-trust.[1]

This paper is broadly concerned with depicting the United States anti-trust enforcement record under these dual sets of anti-trust laws in the distribution sector of the economy. Because of limitations of space and time, the discussion will be confined to anti-trust enforcement within a single industry, food retailing.

Food retailing is one of the most important industries in the distribution sector of the United States economy, and the largest in terms of sales[2] and amount of anti-trust resources devoted to it.[3] As such it exemplifies both the achievements and problems of anti-trust enforcement in distribution and the use of economic analysis in addressing enforcement problems.

The first part of this paper discusses the structural and behavioral dimensions of the food retailing industry which are relevant to understanding the set of anti-trust policies and goals which are responsive to these dimensions. The second part discusses for each of the two major areas of analytic and policy relevance—the structural area of mergers and behavioral area consisting of the various methods of price and non-price competition employed by the industry—just what actual policy is in each area, what is its basis, and what are the conditions which influence its success.

II Structural and behavioral dimensions of the food retailing industry

Food retailing in the United States since World War II—the period with which policy and this paper are concerned—has experienced increasing market dominance by a relatively few large firms operating multi-store chains nationally and regionally.[4] In turn

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I wish to acknowledge the substantial research work and analytical reasoning which went into this paper by my Economist Advisor, Edward J Heiden, on leave from the Economics faculty of the University of Wisconsin.

[1] Of course, such division of anti-trust laws into categories of structural and behavioral is arbitrary to some extent since behavior and behavioral rules have decisive effects upon structure, e.g. a rule against predatory conduct may ease the structural barriers to entry, and rules aimed at preserving the structural conditions of competition have effects upon behavior, e.g. lowering concentration in an industry undermines one of the basic preconditions for success of a price fixing agreement. The classifications are still convenient, however, in providing an organizational framework for discussion. Furthermore, the distinction between rules affecting the way men behave and rules affecting the conditions which cause them to behave the way they do is a fundamental organizational principle in all the social sciences, and in the law.

[2] See National Commission on Food Marketing, *Organization and Competition in Food Retailing*, Technical Study No. 7, June 1966, pp. 1–4.

[3] Source: Federal Trade Commission.

[4] For a view of pre-World War II structural characteristics of the food retail market, see Clair Wilcox, *Competition and Monopoly in American Industry*, TNEC Monograph No. 21, p. 57, and M. A. Adelman, *A & P: A Study in Price-Cost Behavior and Public Policy*, Cambridge, Mass., Harvard University Press, 1959.

The number of grocery stores companies has declined from 350,000 in 1948 to 219,000 in 1963. Whereas the number of food firms operating one to three stores [illegible] of about 130,000, the number of companies with [illegible] stores rose by only seventy. For each of the [illegible] metropolitan areas of the Bureau of the Census [illegible] States this represents a net increase of less than [illegible] standard metropolitan area, and a decline [illegible] single-store retailers per standard metropolitan [illegible] Source: U.S. Census of Business, 1948 [illegible] Line Statistics. Census of Business [illegible] Statistics. By 1963, food store chains [illegible] accounted for 44.5 per cent [illegible] 14 per cent since 1948 [illegible] per cent of the market [illegible] 1963, these chains [illegible]

concentration in the industry has increased significantly both on a national and, perhaps more importantly for defining competitive significance, on a local market level.[5]

Several factors appear to have increased concentration by favoring the multi-unit operator over his smaller independent counterparts. While technical economies of scale at the store level do not appear to require large multi-unit chains,[6] several other social and economic factors work in their favor. Among these are the popularity and convenience of large shopping centers as a result of the flight to the suburbs;[7] the ability of the large chains to enjoy advantages of large scale buying and newspaper advertising;[8] large chains' greater ability to employ promotional activities such as trading stamps[9] and to establish their own private brand merchandise through vertical integration into food manufacturing which gives them added purchasing leverage;[10] and large chains' greater ability to sustain substantial losses over long periods of time.[11]

In addition, mergers, both horizontal and more especially of the market extension variety, have been an important source of increased concentration, accounting for the bulk of the increase in the top twenty chains' share of national sales from 26 to 34 per cent between 1948–63.[12]

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for 35·1 per cent of total grocery store sales, and between 1948 and 1963 the twenty largest food chains of each year expanded their share of food store sales from 23·1 to 31·3 per cent. These problems are discussed in Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behavior of Food Retailing*, January 1966, Chapter XI and especially the Appendices.

5 By 1963 the four largest retailers typically held 45 per cent of grocery store sales in large metropolitan areas (from 43·7 per cent in 1954) and 54 per cent in smaller ones (up from 76·4 per cent in 1954). This followed upon an even more rapid increase in such concentration between 1948 and 1954. Indeed in many markets the eight largest supermarket operators alone apparently controlled practically all supermarket sales. Ibid., pp. 7–11, 23–4.

6 The estimated minimum optimum scale of store of approximately $500,000 is an entry barrier which is relatively low compared with the post-World War II initial investment in other major industries. See Joe Bain, *Barriers to New Competition*, Cambridge, Mass.: Harvard University Press, 1962, p. 72. On the minimum optimal scale of 'plant' in food retailing, see also *Final Report of the National Commission on Food Marketing*, June 1966, pp. 71–2; also, Super Market Institute, *The Super Market Industry Speaks, 1965, 17th Annual Report by the Members of the Super Market Institute*, 1965; Federal Trade Commission, *Economic Inquiry into Food Marketing*, Part I, p. 59.

7 The large concerns are more able to obtain financing and access to shopping centers than their smaller rivals since developers and creditors generally prefer large well-established chain retailers to occupy the desirable sites for new markets and shopping centers. These sites are in many cases the only source of opportunity for new expansion in a society whose growth is almost entirely in suburbs outside the central city and in which the economic life of those suburbs revolves around large shopping complexes. For a discussion of the problems small retailers face in entering shopping centers, *see* US Congress, Senate Select Committee on Small Business, *Lease Guarantees*—1961, 87th Cong., 1st Sess., December 18–19, 1961; US Congress, House Select Committee on Small Business Hearings, *Small Business Problems in Food Distribution*, Part I, Volumes I and II, 86th Cong., 1st Sess., 1959; Senate Select Committee on Small Business Hearings, *Shopping Centers—1959*, 86th Cong., 1st Sess., 1959; ibid., *The Impact of Suburban Shopping Centers on Independent Retailers*, 86th Cong., 1st Sess., 1960, Senate Report, 1016; *In the Matter of National Tea*, Federal Trade Commission Docket No. 7453, Tr., pp. 2187–8, 2194; *In the Matter of The Grand Union Company*, Federal Trade Commission Docket No. 8458, Tr. pp. 770, 771, 1113, 1114, 1288, 1803.

8 It has been estimated that the advertising cost advantage to large retailers translates into 0·8 per dollar of sales or more. *See* Staff Report of the Federal Trade Commission, op. cit., p. 278.

9 *See*, for example, "Competitive Behavior and Trading Stamps in Food Retailing," Testimony of Eugene R Beem, The Sperry and Hutchinson Company, before the National Commission on Food Marketing, 7 May 1965, pp. 835–8; also, Federal Trade Commission, *Economic Report on the Use and Economic Significance of Trading Stamps*, January 1966, p. 20.

10 The tendency toward vertical integration has long been noted. *See* for example A C Hoffman, *Large Scale Organization in the Food Industries*, TNEC, Monograph No. 35, 76th Cong., 3rd Sess., Senate Committee Print (1940), pp. 11–14. It has been increasing at a rapid rate as the value of food products manufactured by the largest forty chains of each year increased by 51 per cent from 1954 to 1963, a third greater increase than for shipment of all US manufacturing plants producing the same product lines. By 1963, food manufactured by the forty largest chains accounted for 8·8 per cent of all their food store sales. The leading individual products manufactured by chains in 1963 were baked goods where the forty largest accounted for 11 per cent, dairy products, meats, fruits, vegetables, and coffee. (*Source:* National Commission on Food Marketing, Technical Study No. 10, *Special Studies in Food Marketing*, Washington, DC, 1966).

Retailers integrate into food manufacturing for what appear to be traditional economic reasons: to achieve economies of scale or eliminate planning uncertainties; to introduce a new technology or change a marketing process; or to share in oligopoly profits. (*See* Richard B Heflebower, "Mass Distribution: A Phase of Bilateral Oligopoly or of Competition", *Papers and Proceedings of the 69th Annual Meeting of the American Economic Association*, Cleveland, December 1956, p. 181; Willard F Mueller and Leon Garoian, *Changes in the Market Structure of Grocery Retailing, 1940–58*, The University of Wisconsin Press, 1961.

11 *In the Matter of National Tea*, Docket No. 7453, Findings as to the Facts, Conclusions and Order, 4 March, 1966, Findings 43 to 56; *US v. Safeway Stores, Incorporated, et al.*, Criminal No. 9584, Transcript, pp. 71–4. For a general discussion of firm conglomeration as a source of market power, see Corwin D Edwards, "Conglomerate Bigness as a Source of Power", in *Business Concentration and Price Policy*, National Bureau of Economic Research, 1955.

12 Two time periods of intensive and extensive merger activity for this industry stand out, the 1920s and the post-1948 period. The merger movement in food retailing in the 1920s brought about a fundamental industry restructuring, greatly expanding the size and scope of operations of several leading chains who in most cases remained dominant until the present time. *Source:* Staff Report of the Federal Trade Commission, op. cit., p. 152.

Whereas horizontal mergers (acquisitions into the same county or market area) accounted for 44·7 per cent of all mergers between 1949 to 1954, they accounted for only 24·0 per cent in 1960 to 1964. Market extension mergers (acquisition into either different states or different counties of the same state) are up from 32·7 per cent for 1949 to 1954 to 40·9 per cent for 1960 to 1964, and combined horizontal and market extension mergers (those with some stores in the same and some in different counties or states) are up from 22·6 per cent in 1949 to 1954 to 35·1 per cent in 1960 to 1964. *Source:* Federal Trade Commission.

Beginning in 1955 acquisitions increased to between $400 and $500 million a year, most made by the nation's 20 largest chains. Measured by sales size of acquired units, 11 chains with sales of $500 million or more in 1963 made about 50 per cent of all recorded acquisitions. On the other hand, less than 20 per cent of acquired units were obtained by 102 retailers with annual sales under $100 million. It has been estimated that had large chains made no acquisitions, their share of US grocery store sales would have been increased by less than one percentage point during the 1948 to 1963 period. (*Source:* Staff Report of the Federal Trade Commission, op. cit., p. 168.) The report goes on to say "Absent the merger movement of the 1950s and early 1963 in grocery retailing, the lower echelon of top chains would have gained less, the national market share of the four largest chains would have declined, and there would have been no significant increase in the market share held by the twenty largest grocery food chains of 1963. Nor would there have been any significant increase in

The variety of price and non-price competitive strategies used by large firms vis-a-vis their smaller rivals have also contributed to increased concentration. Among these are the employment by large chains of their own private brands selling at lower prices than national brands;[13] selective price cutting in response to actual or potential competitors' moves,[14] inducement by the large chains of price discriminations from food manufacturers,[15] the use of frequently purchased loss-leaders or low profit items as advertising come-ons;[16] the large chain policy of charging higher prices in stores located in areas of 'soft' competition than in vigorously competitive areas (a practice which had tended to mean that blacks located in ghettos, where the incentive for a chain to locate is low, pay more than white suburbans located in prosperous and thus more competitive areas);[17] and the use of a variety of non-price promotional strategies such as mass media displays which are simply not practically available to smaller retailers.[18]

At one time or another many large retail chains in this industry have also engaged in various types of directly restrictive practices and restraints such as buying up locations ahead of demand, refusing and threatening to refuse to deal, and engaging in reciprocal dealing where they occupy vertical positions in manufacturing or wholesaling.[19]

Despite the use of price and promotion as strategic competitive tools, interdependence among chains in various markets is rather large, as price and promotion levels of competitors are closely watched, especially in markets which are fairly highly concentrated.[20]

III Focus of anti-trust enforcement policy in food retailing

In developing an anti-trust policy for any industry or segment of the economy, the mere existence of increased concentration does not by itself necessarily demonstrate the need for corrective action. The increase may have stemmed from technological imperatives, or scale economies, such that attempts at restructuring such industries into smaller units might impede rather than promote competitive vitality. Anti-trust policy aimed at slowing or reducing increases in concentration can only be worthwhile where the high concentration of activity among industry members can be shown to be associated with increased market power and potential for anti-competitive performance on the part of firms possessing it.

There is abundant evidence of the anti-competitive market power which flows from increased concentration in industries in general[21] and in food retailing in particular, e.g. the finding that the increased market share among large chains has been associated with an average profit yield for them consistently higher than for intermediate chains and smaller firms,[22] and that this has been a manifestation of market power rather than due to superior efficiency.[23] Thus together

national concentration' the top twenty chains of 1948 held at 26·9 per cent of sales in that year, which is identical to the estimated share of sales which the twenty largest chains of 1963 would have held in 1963 had they made no mergers" (Ibid., p. 170).

[13] One *Progressive Grocer* study revealed that 10 per cent of all grocery and frozen food items handled by big chains consisted of private brands. Further, it was reported that in large chains private brands sold for an average of 17 per cent less than national brands, in regional chains for 14 per cent less. (*Source* "Where We Stand Today in Private Brand Merchandising", *Progressive Grocer*, August 1959, p. 6.)

[14] *See US v. Safeway Stores, Incorporated, et al.*, Criminal Action No. 9584, information filed 1 November, 1955.

[15] Staff Report of the Federal Trade Commission, op. cit., pp. 184–6.

[16] In an interview with twenty executives in the supermarket and the food field, one author found universal agreement as to the effectiveness of leader pricing, all agreeing that they used it. *See* Rom J Markin, *The Supermarket: An Analysis of Growth, Development, and Change*, Washington State University Press, 1968, p. 89; *see also* for related discussion Bob R Holdren, *The Structure of a Retail Market and the Market Behavior of Retail Units*, 1960, p. 73. For a general discussion of philosophy of pricing behaviour, *see* Holdren, op. cit., pp. 67–100, and Paul E Nelson and Lee E Preston, *Price Merchandising in Food Retailing. A Case Study*, Institute of Business and Economic Research, University of California, 1966. For a discussion of a particular philosophy of pricing, *see US v. New York Great Atlantic and Pacific Tea Company*, 67 F Supp. 626 (1946), transcript of hearings, Vol. 50, pp. 11049–50.

[17] While some stores charge the same price for all products in all stores in a given trading area (though making adjustments to meet special competitive conditions), others use a zonal pricing system whereby they have two or more different sets of prices over a given area for broad categories of items such as dry groceries, meats, or frozen foods. Still other chains charge different prices on a store-by-store basis within a given area of their operation. Markin, op. cit., pp. 87–8; Staff Report to the Federal Trade Commission, *Economic Report on Food Chain Selling Practices in the District of Columbia and San Francisco*, pp. 21–3. One interesting finding of the DC—San Francisco food chain pricing study was that with respect to one particular area, Washington, DC, consumers in stores located in low-income areas experienced a significantly higher rate of unavailability of items that had been specially advertised than those in higher income areas or in the suburbs. … per cent of advertised specials surveyed were not available in … income areas, to 9 per cent were unavailable in the suburbs, differences being statistically significant. Ibid., p. 30.

… figure was obtained from the Supermarket Institute. *See* … A Howard, *Marketing Management: Analysis and* … 1963, p. 387.

[19] *See* Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behavior of Food Retailing*, pp. 105–49.

[20] One source indicates that in most local and regional trading areas, there appears to exist a rather well-defined and established "pecking order" among supermarkets as to who dares make price cuts and as to the extent of the price reduction. *See* Markin, op. cit., p. 86.

[21] *See* Joe S Bain, "Relation of Profit Rate to Industry Concentration. American Manufacturing, 1936–1940", *Quarterly Journal of Economics*, Vol. LXV (August 1951), pp. 293–324; Norman R Collins and Lee E Preston, *Concentration and Price-Cost Margins in Manufacturing Industries* (Berkeley University of California Press, 1968), William S Comanor and Thomas A Wilson, "Advertising, Market Structure and Performance", *The Review of Economics and Statistics*, Vol. XLIX (November 1967), pp. 423–40, H Michael Mann, "Seller Concentration, Barriers to Entry and Rates of Return in Thirty Industries, 1950–1960", *The Review of Economics and Statistics*, Vol. XLVIII (August 1966), pp. 296–307; Leonard W Weiss, "Average Concentration Ratios and Industrial Performance", *Journal of Industrial Economics*, Vol. XI (July 1963), pp. 237–54.

[22] These remarks apply to the period ending 1962 in some cases and 1964 in others. *See* Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behavior of Food Retailing*, pp. 252, 260 69, *see also Operating Results of Food Chains, 1964–5*, Cornell University, summary tables, pp. 14–16.

[23] The relation between profitability and the measurement of market power using rate of return as a proxy variable for market power is fully treated in Joe S Bain, "Profit Rate as a Measure of Monopoly Power", *Quarterly Journal of Economics*, February 1940, pp. 271–93.

with other statistical evidence[24] as well as evidence—to be described below—developed in litigation, has strongly suggested that an anti-trust policy aimed at combating industry concentration among the larger chains could effectively promote competition.

To this end, anti-trust policy in food retailing has focused on three major areas of industry conduct each of which shall be discussed in order: (1) acquisitions; (2) non-price behavior; and (3) industry pricing strategies.

(A) ANTI-TRUST REGULATION OF ANTI-COMPETITIVE MERGERS

In essence, United States anti-trust policy toward mergers is embodied in Section 7 of the Clayton Act[25] which provides in general terms that any merger which may lessen competition shall be illegal.

The Courts, who exclusively decide cases brought by Justice, and the Federal Trade Commission, who initially decides the complaints which it brings, through their legal opinions develop and delimit theories of anti-competitive violation in individual litigated cases and give specific content, form and applicability to the general standard of illegality laid down in Section 7.[26]

In recent years merger decisions have increasingly demonstrated the Courts' and the Commission's concern not only with the immediate impact which a merger and the increased aggregate or local concentration resulting from it may be found to have on anti-competitive performance, but also with the question of whether *in the longer run* it will trigger a merger trend in the industry or intimidate existing competitors or deter future potential entrants through erecting barriers to their entry.[27]

Such a policy, at the same time futuristic and current and aimed at actual as well as potential harm to competition, has been applied through the filing of formal complaints to mergers in food retailing on a significant scale.[28] The ensuing cases have provided strong evidence of the relationship between mergers, increased concentration and anti-competitive behavior and performance. For example, the National Tea case showed how a large chain buyer grown strong by merger could wrestle favorable discriminatory deals from smaller suppliers, and how National as a large multi-regional chain could and did charge higher prices in areas where it had significant market shares and could subsidize operations in losing cities out of the deep pocket of profitable cities.[29] Examples such as this and others[30] caused enforcement officials to

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24 For instance, it has been shown that the increase in market share among large chains has gone hand-in-hand with a rise in their gross margins (difference between sales and costs, expressed as a percentage of sales) to the point that they were considerably above those of the smaller chains and independent grocers; and has been linked with an average rate of return on stockholder investment in food retailing which is above the national average for all manufacturing, all retail trade, and all food and kindred products manufacturing. *Final Report of the National Commission on Food Marketing*, June 1966, pp. 71–2; also Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behavior of Food Retailing*, pp. 274–5.

25 There are other anti-trust laws as well which are applicable to mergers. Section 2 of the Sherman Act prohibiting monopolization or attempts to monopolize is applicable to mergers and for a time (1892–1914) was the only anti-trust law so applicable. Also, Section 5 of the Federal Trade Commission Act prohibiting unfair methods of competition has applicability to anticompetitive features of mergers. However, only Section 7 of the Clayton Act is specifically aimed at mergers, and it is the anti-merger law under which by far the greatest number of anti-merger actions are brought.

26 For a detailed discussion of the legal procedure and mechanics of US anti-trust enforcement, including anti-merger enforcement, *see* Clair Wilcox, *Public Policies Toward Business*, 1966, pp. 18–45 and 91–115.

27 This policy is rooted in several recent cases. It has been stated that the Clayton Act is designed "to cope with monopolistic tendencies in their incipiency", *United States v. Bethlehem Steel Corporation*, 168 Federal Supplement 576, 583 (DC SDNY, 1958). Further in *Philadelphia National Bank*, the Supreme Court wrote that judgment of the anti-competitive impact of a merger "requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact on competitive conditions in the future; this is what is meant when it is said that the (anti-merger law) was intended to arrest anti-competitive tendencies in their 'incipiency'". *United States v. Philadelphia National Bank*, 374 US 321 (1963). This same philosophy was followed in *United States v. Continental Can Co.*, 378 US 441 (1944), where the Court considered its holding that a merger violated the anti-merger statute as "consonant with the purpose of §7 to arrest anti-competitive arrangements, in their incipiency".

28 Willard F Mueller, "Can the Anti-trust Laws Prevent Monopolistic Food Prices?" Paper presented at Co-operative Extension Service North Central Workshop, "Corporation Farming—What Are the Issues?", Chicago, Illinois, 21 April, 1969, pp. 9–18.

The first case challenged thirteen acquisitions made from 1952 to 1958 by the National Tea Company, the fifth ranking grocery chain on a national basis. *In the Matter of National Tea Company*, Docket No. 7453, 26 March, 1959. The second case against the Kroger Company challenged five acquisitions made from 1955 to 1958 by that chain, the third ranking grocery chain in the country. *In the Matter of the Kroger Company*, Docket No. 7464, April 1959. In 1962, the Commission filed a complaint against two acquisitions of direct competitors by the Grand Union Company, tenth ranking chain in the United States. *In the Matter of Grand Union Company*, Docket No. 8458, 12 January 1962. Justice Department in the meantime filed a case in 1960 against the Von's Grocery Company, the third ranking Los Angeles chain, challenging its acquisition of Shopping Bag, the fifth largest chain in the same market. *US v. Von's Grocery Company*, Southern District of California, 25 March, 1960. In 1966 the Commission filed a complaint against Consolidated Foods Corporation challenging its acquisitions of three grocery chains. *In the Matter of Consolidated Foods Corporation*, Docket No. C-1024, 21 December, 1965. Finally in September 1966 the Commission filed an action against Winn Dixie Stores, Inc. *In the Matter of Winn Dixie Stores*, Docket No. C-1110, September 1966. A related matter although not directly involving a food retailing merger is *FTC v. Consolidated Foods Corp.*, US Supreme Court, No. 422, October 1964.

29 *National Tea Company*, Docket No. 7453, Opinion of the Commission, 4 March, 1966, Tr. 1949; pp. 13–14; Findings, pp. 44, 46, 56–7; 65; *Supermarket News*, 3 May, 1965, pp. 32–3, and 26 April, 1965, p. 23.

30 In litigated proceedings involving Consolidated Foods Corporation, one of the nation's largest firms and a vertically integrated food manufacturer, processor, and wholesaler, who had also gained a vertical-forward position in food retailing, the Commission found—again confirmed by the reviewing courts—that Consolidated had entered into reciprocal purchasing arrangements in some markets with other wholesalers whereby Consolidated and these wholesalers agreed to purchase certain product lines from each other thus foreclosing other competitors from their patronage. (*FTC v. Consolidated Foods Corp.*, US Supreme Court, No. 422, October 1964.) Consolidated's mergers into retailing, by putting it in a position to buy from other wholesalers, were part-and-parcel of the conditions which made such anti-competitive reciprocity arrangements possible, to the detriment of other retailers who presumably would obtain less favorable terms in buying merchandise comparable to what Consolidated could obtain under its reciprocity arrangements. Other evidence

generalize beyond National to what would happen if a rapidly growing merger movement created many such Nationals. It became increasingly obvious that an unchecked merger movement, whose anatomy and linkages to anti-competitive performance were being portrayed simultaneously by statisticians and economists, could lead only to a situation where small actual or would-be competitors depending for their success on one or a few markets would become permanently intimidated in their competitive encounters with the large chains. It was felt the situation would become one where the same few large chains would share dominance across the broad national spectrum of local food markets by living in a pattern of mutual accommodation where everybody, as National had put it, 'pretty well shared the same view of competition'.[31]

Such industry-wide concern was reinforced by the record and recommendations of a presidentially-appointed National Commission on Food Marketing appointed by the President and by conferences with industry officials.[32] It led to a generalized enforcement statement denominated in 'guidelines' which attempted to define for the entire industry the types [illegible]

permissible merger activity by indicating precisely in terms of market shares and dollar value of sales what kinds of mergers the enforcement agencies (in this case the Commission) would tend to regard as anti-competitive and would prosecute through issuance of complaints in the absence of mitigating circumstances.[33]

The intent of merger policy has been to make in- [illegible]

Commission) for a five or ten year period,[34] and stopping mergers of all the other large retailers not under litigation simply through moral suasion of the guidelines and their implied threat of litigation. In addition to the preventive aim of stopping large-chain mergers,

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was adduced for other markets in which Consolidated operated that its interests as a processor made it difficult for it to be a vigorous competitive operator of supermarkets. As a processor selling to other supermarket customers, it was fearful of developing "hard" competition in its supermarket operations lest it antagonize those customers who competed with it in retailing (*In the Matter of Consolidated Foods Corporation*, Docket No. C-1024, 21 December, 1965; and Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behavior of Food Retailing*, January 1966, pp. 145–6.)

Still other cases brought by the enforcement agencies involving food retailers provided further evidence of the interrelationship between mergers, increased concentration, and anti-competitive behaviour and performance in this industry. These others besides Consolidated and National Tea are the same cases discussed above in footnote 28. *See* footnote 34, infra, for additional discus- [illegible] p. 12.

32 See *Final Report of the National Commission on Food Marketing*, June 1966, and National Commission on Food Marketing, *Organization and Competition in Food Retailing*, Technical Study No. 7, June 1966.

33 Federal Trade Commission, *Enforcement Policy with Respect to Mergers in the Food Distribution Industries*, 3 Jan 1967. The guidelines focus on the merger behaviour of the very largest national chains, "exempting" in general the medium sized regional and local chains—which according to available economic evidence (*Final Report of the National Commission on Food Marketing*, June 1966, pp. 71–2) are the most viable competitive economic units in the industry. The guidelines state that mergers and acquisitions by either retail food chains or by voluntary and co-operative groups of food retailers resulting in annual food store sales in excess of $500 million are those which will warrant Commission attention, and further that those with combined annual sales over $100 million will warrant such attention whenever companies which are leaders in important metropolitan areas merge with competitors who are also leaders in the same market and where they appear to be part of a series promising to create another giant. Exempted are mergers and acquisitions of not more than four food or grocery stores or food establishments with sales of less than $5 million or food establishments resulting in a combined market share of less than 5 per cent of total food store sales in a relevant city or county market. The guides require premerger notification for all food retailers and wholesalers with annual sales over $100 million who contemplate merger at least sixty days prior to the consummation of merger with another food retailer or wholesaler. Since these guidelines were issued three subsequent sets of formally presented guidelines for the cement industry, the grocery products manufacturing industry, and the textile mill products industry have been issued by the Commission and a general set of merger guidelines has been issued by the Department of Justice. One might also say that the exemplary effect of the *Von's* case referred to in the preceding footnote which condemned as anti-competitive a horizontal merger of a firm of 4.7 per cent with one of 4.2 per cent share of an expanding Los Angeles market constituted implicit horizontal market share guidelines. However, the "lesson" of *Von's* was never made a part of a formal set of food retailing guidelines by Justice.

34 Divestiture has not been widely used by the Federal Trade Commission to effectuate these objectives. In part this has been due to the fact that: (1) Since the anti-competitiveness of merger behavior frequently did not arise from any one given acquisition, but rather from an entire series of mergers, divestiture would have to be of a wholesale variety, and anti-trust enforcement has been loath to apply divestiture on a mass scale; (2) It was felt that divestiture would be inequitable as between those firms whose mergers happened to be touched by litigation and those whom litigation avoided but whose mergers nevertheless also contributed to the total anti-competitive effect in the industry; (3) It was felt that the possibility of new entry, which a positive industry-wide merger policy might open up, would dissipate over time the anti-competitive effects of existing mergers in many cases, thus rendering divestiture unnecessary.

Divestiture has been ordered for those mergers for which the anti-competitive impact was solely due to the given mergers and not the fact that these mergers were part of a larger totality. Thus it was ordered in the Consolidated Foods matter (*In the Matter of Consolidated Foods*, Docket C-1024, decision and order, 21 December 1965) where Consolidated, entering into a consent settlement with the Commission, agreed to divest retail stores with combined sales in excess of $200 million and further agreed to a ban on future acquisitions of retailers without prior Commission approval. Here specific vertical mergers of processor-wholesaler Consolidated into retailing could be isolated as the specific cause of anti-competitiveness in a given situation (reciprocity, reluctance of Consolidated as a retailer to engage in "hard" competition with other retailers who bought from it as a supplier), so that divestiture seemed an appropriate remedy for a specific anti-competitiveness offence. Similarly, the Grand Union Company signed a consent settlement requiring divestiture of certain acquired super- [illegible]

Thus divestiture has been ordered where market power is directly traceable to specific mergers, but not in general where it is the result of a cumulative series of mergers.

the enforcement policy as stated has more positive aims as well—to rechannel the merger movement towards smaller local and regional chains, thus enhancing their competitive position vis-à-vis the larger chains and to force the larger chains to move into new markets via internal expansion rather than merger.

The enforcement hope has been that the merger policy will give a new lease on independent life to those firms who might otherwise have been acquired by large chains; that it will serve to halt the expansion in the number of points of conglomerate contact by the nation's largest chains across the range of the nation's local markets, thereby reducing the market power of the large conglomerate chain retailers and their ability to engage in entry-barring conduct such as discriminatory pricing and deep-pocket subsidization;[35] and that it will lessen the degree of intimidation which smaller actual or would-be competitors feel, thus making for a more vigorous level of retailer competition.

In addition, it is hoped that merger policy toward food retailing would have salutary effects upon other industries as well. By encouraging the presence of a greater number of firms in local markets, it should stimulate the provision of more shelf space and thus should help to reduce the significance of shelf space scarcity as a barrier to entry of new firms at the food manufacturing level.[36] Thus it should ease the necessity for a new entrant or existing seller of grocery or non-grocery products carried in food stores to win or keep his shelf space in the stores via price discrimination or via an excessive level of brand differentiation.

It is not known whether merger policy of the Justice Department and the Commission has had or will have all these salutary effects, nor could it ever be known for sure that merger policy was responsible for them if indeed they were shown to occur, since other causes could be simultaneously at work achieving the same beneficial results.

What is known, however, is that since the 1966 Supreme Court's decision in *Von's Grocery* condemning a horizontal merger of firms with small percentages of the market, together with several unfavourable Commission litigated decisions and the Commission enforcement guidelines, horizontal mergers which directly increase concentration have become few and far between and, as Table I (seq.) makes clear, the top twenty chains' rate of acquisition has slowed considerably, and acquisitions by the top ten chains have virtually ceased. Smaller chains have replaced larger ones in consummating the bulk of acquisitions, in line with one of the ancillary aims of the guideline enforcement policy, i.e. the aim of channelling mergers toward those smaller firms whom growth by acquisition could be expected to make more efficient and more competitive.[37]

At the present time a follow-up study is being conducted to assess the additional effects of the merger enforcement policy, i.e. whether the hoped-for diversion of large chains to growth by internal expansion has been accomplished, whether the extent and nature of vertical integration has changed, and

[35] Anti-trust enforcement policy toward food retailing has been accused in the past of not sufficiently recognizing the importance of entry conditions. *See* Dissenting opinion of Mr Justice Stewart, *US v. Von's Grocery Co.*, Trade Regulation Reports, Commerce Clearing House, Inc., 1966, §71, 780; also Dissenting opinion of Commissioner Elman, *In the Matter of National Tea*, Docket No. 7453, Opinion of the Commission, 4 March, 1966.

[36] *In the Matter of National Tea Company*, Docket No. 7453, Opinion of the Commission, 4 March, 1966. Shelf space scarcity constitutes an effective entry barrier because it implies that retailers having such scarce shelf space will tend to give preference to those goods which are already effectively presold to the consumer by brand differentiation, thus advantaging the large supplier who can afford to outadvertise his competitors, and it also puts the large suppliers who are in a better position to grant discriminatory cost concessions to a retailer to capture or keep such shelf space at a competitive advantage vis-à-vis smaller suppliers who cannot afford to make such concessions. On the question of shelf space as an entry barrier, *see* Economic Report of the Federal Trade Commission on *The Baking Industry*, 1967.

[37] Again, for evidence of the gains in competitive efficiency to be obtained by small chains through additional growth, *see Final Report of the National Commission on Food Marketing*, June, 1966, pp. 71–2.

The acquisitions by these smaller firms have brought the merger movement to new heights. In 1967 to 1968 the total acquired grocery store sales were \$2·147 billion, compared with \$1·97 billion for 1965 to 1966, and \$2·11 billion 1960–1964. *Source:* Willard F Mueller, "Can the Anti-trust Laws Prevent Monopolistic Food Prices?" loc. cit.

Table I

Retail grocery store acquisitions, by time periods, 1949–1968

Period	*Total acquired grocery store sales (millions)*	*Stores acquired by top twenty chains* — *Sales of acquired stores (millions)*	*% of total sales*	*Stores acquired by top ten chains* — *Sales of acquired stores (millions)*	*% of total sales*
1949–54	\$ 333	\$ 244	72	\$ 212	64
1955–59	2,164	1,466	68	863	40
1960–64	2,011	1,438	72	1,054	52
1965–66	1,097	171	16	108	10
1967–68	2,147[a]	73[b]	3	6	[c]
Total	\$7,752	\$3,392	44	\$2,243	28

[a] Includes grocery stores with sales of \$1·062 billion acquired by non-food store chains.
[b] The figure excludes the acquisition of Consolidated Food Stores' Eagle supermarkets by Lucky Stores pursuant to an FTC divestiture order because both chains were among the eleventh to twentieth size class.
[c] 0·3 per cent.
Source: Federal Trade Commission.

what direction the pace of merger activity among smaller chains has taken.[38]

(B) REGULATION OF FOOD RETAILERS' NON-PRICE AND PRICE CONDUCT

In addition to its 'structural' commitment to address anti-competitive increases in food retailing concentration through an active merger policy, American anti-trust enforcement reflects a commitment as well to the regulation of the varieties of anti-competitive *conduct* which also serve to increase concentration. In addition to several relevant statutes which prohibit specific types of anti-competitive conduct,[39] Section 5 of the Federal Trade Commission Act contains a broad prohibition against 'unfair' methods of competitive conduct and gives the agency charged with enforcement of the Act, the Federal Trade Commission, the power to regulate the competitive strategies of firms—both of the price and non-price or promotional variety—which it finds violate the legislative requirement of fairness to competitors and/or consumers.

Regulation of each of the two types of competitive strategies which food retailers employ—non-price and price—will be discussed seriatim.

1 *Regulation of non-price competition*

American anti-trust policy toward the food retailing industry has focused extensively on the anti-competitive possibilities inherent in the various forms of non-price competition.[40] The following is a very brief summary of enforcement efforts in the four major areas of enforcement concern.

(a) Trading stamps

In terms of dollar value of expenditures, trading stamps have been the most important form of non-price competition among retailers.[41] Anti-trust policy with respect to trading stamps as a method of competition has been aimed at increasing the options available to retailers to use them competitively, and has been less concerned with removing the barriers to their use by small and medium sized firms. It has been not at all concerned with scaling down their competitive significance. Specifically, anti-trust policy toward trading stamps has taken the form of litigation aimed at enabling retailers to have more flexibility in setting their own exchange value of stamps vis-à-vis value of merchandise sold, thus sharpening the edge of stamps as a device of price competition.[42] In addition, litigation has aimed at

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[38] Federal Trade Commission, *Special Report, Acquisitions, Mergers and the Corporate Structure and Integration of Selected Food Distributors*, 1 January 1965 to 30 January 1969.

[39] Section 1 of the Sherman Act prohibits 'every contract, combination, in the form of a trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations', i.e. price fixing. Section 2 of the Sherman Act prohibits monopolization, and attempts and conspiracies to monopolize by or among firms. In addition, where the effect may be substantially to lessen competition or tend to create a monopoly, it is illegal, (1) to enter into exclusive or tying contracts (Clayton Act, Section 3); (2) to discriminate among purchasers to an extent that cannot be justified by a difference in cost or as an attempt made, in good faith, to meet the price of a competitor (Clayton Act, Section 2 as amended by Robinson–Patman Act, Section 2 (a)), (3) to pay a broker's commission if an independent broker is not employed (Robinson–Patman Act, Section 2 (c)), (4) to provide supplementary services to a buyer or to make allowances for services rendered by a buyer unless such concessions are equally available to all buyers (Robinson–Patman Act, Sections [illegible] discrimination in price (Robinson–Patman Act, Section 2 (a)), (7) to serve as a director of competing corporations (Clayton Act, Section 8); (8) to employ deceptive acts or practices (Federal Trade Commission Act, Section 5 as amended by Wheeler Lea Act, Section 3).

[40] Among the stronger anti-competitive possibilities suggested in the literature are: higher prices to consumers than would prevail under conditions of perfect competition without such expenditures, rates of return in excess of the normal prevalent under competition and wasteful deployment of resources and duplication of capacity that could otherwise be translated into more socially desirable uses.

The research arm of the anti-trust effort to explore the variables of policy making has been actively engaged in studying the importance and contribution of various types of nonprice behavior to market structure and to the key indicators of economic performance such as gross margin of retailers and prices to consumers.

Studies prepared by the economic staff of the Commission indicated that from 1953 through 1964, expenditures of food retailers on nonprice promotional devices such as trading stamps and more elaborate store facilities increased by a larger percentage than any other expense category. (Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behaviour of Food Retailing*, January 1966, pp. 246–60. *See also* 'Operating Results of Food Chains', prepared in co-operation with the National Association of Food Chains by Harvard University, 1953 through 1961, and by Cornell University for 1962–1963 and 1963–1964.)

Trading stamps—coupons given to customers which have a cash redemption value in proportion to the value of purchases when collected in sufficient quantity in a specially provided book—and games of chance—various gaming-type devices framed on cards given shoppers in which consumer has a chance to win cash and other prizes—which have been two of the most frequently used promotional devices, have been specifically associated with increased market power in the form of significantly increased gross margins (difference between sales and cost of goods sold, expressed as a percentage of sales) on the part of some large chain retailers using them. Further, they have been associated with increased food store prices—by an amount about equal to cost of the device in the case of stamps (Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behaviour of Food Retailing*, January 1966, pp. 224–31), and by somewhat less than cost of provision in the case of games of chance (Staff Report to the Federal Trade Commission, *On the Use of Games of Chance in Food and Gasoline Retailing*, 1968, pp. 449–55).

For a general discussion of some of the more general theoretical and empirical relationships between non-price competition and elements of anti-competitive performance, see, among others, E H Chamberlin, *Theory of Monopolistic Competition*, 7th ed., Harvard University Press, 1958, Leonard W Weiss, *Economics and American Industry*, 1961, chaps. 4 and 9, Walter Adams (ed.), *The Structure of American Industry*, 3rd ed., 1961, ch. 2.

[41] That is, if we restrict our consideration to expenditures of leading supermarket chains. *See* Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behaviour of Food Retailing*, January 1966, pp. 214–16.

[42] For a discussion of stamps as a device of price competition, and the two-price system which they introduce, see, among others, L J Gordon, *Economics for Consumers*, 1961, p. 870, Harold W Fox, *The Economics of Trading Stamps*, Public Affairs Press, 1968, and Roger Sherman, 'Trading Stamps and Consumer Welfare', *Journal of Industrial Economics*, Vol. 17, November 1968, pp. [illegible]

introducing a greater number of trading-stamp-issuing competitors into a given trading area.[43]

The competitive disadvantage to smaller and medium-sized retailers arising from the fact that consumer acceptance is limited to a relatively few well known stamp programs (five companies issue 75 per cent of all trading stamps) which in many cases have exclusive franchising agreements with large chain retailers, is simply not addressed by trading stamp policy.[44] Nor are the disadvantages addressed which come from the fact that the volume discount structure in the purchase of trading stamps favors the large chain buyers,[45] and from the fact that smaller retailers can still be prevented from offering their customers fewer stamps per dollar of sales than their larger competitors offer, should they want to use this method to overcome their cost disadvantages in purchasing stamps from manufacturers.[46] Such competitive disadvantages may not be serious, however, in light of the fact that restraints upon access to trading stamps may force smaller and medium-sized chains to be more competitive on the basis of price, and thus may be a benefit rather than a competitive disadvantage for the small chains vis-à-vis large retailers, as well as for consumers.[47]

(b) Games of chance

Games of chance are also an important vehicle of non-price competition.[48] As with trading stamps, anti-trust enforcement policy toward games of chance as a vehicle of non-price competition used by food retailers has not been directed at abolishing or scaling down the significance of these games,[49] or at addressing the competitive disadvantages to smaller retailers arising from this form of promotion,[50] but rather has been directed toward requiring detailed disclosure of the odds of winning.[51] On the one hand, it is possible that smaller retailers' inability to use these game promotions on a competitive par with the large chains could disadvantage them competitively, but on the other hand it is also possible that as with stamps smaller retailers may be compelled to resort to price competition to counter these promotions which—if true—would seem to serve the competitive policy objectives of anti-trust.

43 There were two pieces of litigation in question here.

The first was a complaint issued on 15 November 1965, alleging that one of the largest producers of trading stamps, The Sperry & Hutchinson Company, violated Section 5 of the Federal Trade Commission Act (FTC Docket No. 8671). The complaint alleged inter alia that the S & H Company required 'contracting retailers not to dispense more than one trading stamp for each full ten cents worth of goods or services, not to give "free stamps", and not to engage in "double stamping" or "bonus stamping" without special authorization or permission from respondents'; that the S & H Company has engaged in concerted activity with other trading stamp companies to prevent the foregoing practices by retailers under contract with such companies; and that the S & H Company and other trading stamp companies have prevented trading stamp exchanges from operating and retail merchants from redeeming trading stamps. Commission order of 26 June, 1968 prohibited S & H from preventing its customers from offering stamps in any amount in excess of a fixed ratio.

In December 1963, the Department of Justice filed a complaint against a stamp-issuing company, several leading supermarket chains, and a drug store chain, charging them with conspiring to restrain trade in violation of Sections 1 and 2 of the Sherman Anti-trust Act, attempting to monopolize and monopolizing the trading stamp business in California. The complaint charged, among other things, that defendant retailers and co-conspirators organized a stamp company and agreed to refrain from the use of any other trading stamps except by agreement of the group; that stamps of that company would be sold and distributed at or above cost so as to stop other stamp companies from effectively competing with it; and that the stamps of that company would be issued only in those areas of California agreed to by the group. *US v. Blue Chip Stamp Company, et al.* Civil Action No. 63-1552 S, Filed 26 December 1963.

The Company was required by consent decree to reorganize or sell its assets and, after the reorganization or sale, to sell one-third of its then existing business, the business to be offered for sale being located within a contiguous geographic area within Southern California. The decree enjoined it from refusing to provide services to retailers because of the retailers' rates of issuance of stamps. (*Trade Regulation Reports*, Commerce Clearing House, Inc., 1967, §72,027.)

44 The fact that apparent limited access by smaller and medium-sized retailers to more popular stamp plans can be a significant competitive disadvantage for these retailers is shown by the fact that about half the supermarket customers interviewed in a sample survey have said they would prefer shopping in a store issuing stamps rather than one charging prices two cents per dollar lower. *Source: 1963 Study of Supermarket Shoppers* (Cincinnati, Ohio: Burgoyne Index Incorporated, 1963), pp. 34 and 36.

45 Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behavior of Food Retailing*, January 1966, pp. 243–4.

46 Dissenting statement of Commissioner Jones, *In the Matter of the Sperry and Hutchinson Co.*, Docket No. 8671, Opinion of the Commission, 26 June 1968.

47 This point is reinforced by the fact that the cost saving from abolition or non-use of stamps could support a price reduction much larger than the price discount represented by the stamps when they are redeemed for other merchandise. (*See* Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behavior of Food Retailing*, January 1966, pp. 230–1; see also footnote 42 supra.) Moreover, a high percentage, albeit not a majority, of customers interviewed in a sample survey expressed preference for shopping in a store which charges lower prices than in one which gives stamps. (1963 *Study of Supermarket Shoppers*, op. cit., pp. 34 and 36.)

48 Staff Report to the Federal Trade Commission, *Economic Report on the Use of Games of Chance in Food and Gasoline Retailing*, 1968, pp. 417–24.

49 Some individual states (New York and Texas) have regulated their use. In Georgia, such a bill is before the legislature, and in two states, Maine and Nevada, legislation outlawing games of chance contests by persons selling 'motor vehicle fuel' has been signed into law. Other states are at present studying the feasibility of special regulation.

50 It has been estimated from the sample of games that the cost of prizes accounts for about 25–30 per cent of the total cost of games, which themselves account for between 1 and 3 per cent of total advertising and promotional expense of nine leading supermarket chains. *Source:* House Subcommittee on Activities of Regulatory Agencies Relating to Small Business of the Select Committee on Small Business, Hearings on 'The Use of Games of Chance in Gasoline Marketing and Their Impact Upon Small Business'; and Federal Trade Commission Survey.

Smaller retailers find themselves unable to take advantage of the volume discounts which are available to the larger retail chains buying game pieces. These discounts are at least partially cost justified by savings accruing to the games supplier in dealing with large chains due to economies of advertising and promoting the games for a given chain retailer and due also to the fact that the overhead expense of large prizes can be spread over a greater number of stores for the large chain. (Staff Report to the Federal Trade Commission, *Economic Report on the Use of Games of Chance in Food and Gasoline Retailing*, 1968, pp. 434–5.)

51 Federal Trade Commission, *Trade Regulations Rule for Games of Chance in the Food Retailing and Gasoline Industries and Accompanying Statement of Basis and Purpose of Rule*, Effective 17 October, 1969, pp. 34–6. In addition the rule provides for random mixture of game pieces and random distribution of winners, as well as detailed disclosure of the number and amount of prizes, and prohibition on use of games where winners can be pre-identified.

(c) Advertising and promotion allowances

Although anti-trust enforcement has not been concerned with the regulation of *quantity* of advertising by food retailers, it has been very much concerned with the extent to which allowances given for advertising and promotion by suppliers or third parties through retailers involve discrimination against smaller retailers and thus injure their competitive viability. There is perhaps an inevitable tendency for these promotional programs to be 'loaded' in favor of large chain purchasers in order to make the program more attractive to manufacturers.[32] In this connection, the anti-trust laws state very specifically that advertising and promotion campaigns whereby heavy-advertising retailers receive either directly or through third parties promotional and merchandising allowances and benefits which are not made available on proportionately equal terms to smaller retailers, are illegal.[33]

The Federal Trade Commission, charged with enforcing this law has brought several successfully litigated cases in this area.[34] In addition, it has issued several guides, rules, and statements elaborating the proportionate equality provision of the law with respect to specific plans and products sold at retail.[35]

Two other anti-trust efforts in the promotional area deserve mention.

Extensive resources of the Federal Trade Commission have been devoted to an ongoing investigation of the advertising discount structure of newspapers, the most frequently employed advertising medium for food retailers. The purpose has been to assess the extent to which that rate structure arbitrarily discriminates in favor of the large retailer, disadvantages the smaller's ability to compete, and intimidates would-be entrants.[36]

Yet another regulatory attempt to improve the competitive quality of promotion as a strategic tool of business rivalry has been in outlawing, through amended Section 5 of the Federal Trade Commission Act, false and deceptive packaging, labelling and advertising by food retailers.[37]

(d) Affirmative disclosure

The Federal Trade Commission has recently initiated a pilot program of requiring affirmative disclosure of relevant operational characteristics for various products, which if successful, could lead to an expansion of effort in the area which would be of great competitive significance for food retailing. The Commission's rule-making power to insure 'fair methods of competition' and to give consumers an environment conducive to more informed decision making in their buying has led to the inauguration of two pilot projects, one requiring refiners to disclose the octane ratings of their gasoline, and the other requiring manufacturers to disclose the effective life of their light bulbs. While these pilot projects do not affect food retailing, it is possible that a program of affirmative disclosure will eventually be used in food retailing to clarify relevant differences between private label brands and more heavily advertised 'name' brands, with a view to assisting consumers to premise their purchases on known variables and on factual considerations such as price per unit, seller reputation, service, and the like. Such extensions of the British 'Teletag' idea are still in their infancy, however.[38]

It is significant that generally speaking, the American anti-trust posture with respect to food retailing advertising and promotion expenditures has been much less stringent than what has been attempted by

[32] Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behavior of Food Retailing*, January 1966, p. 199.

[33] The relevant legislation is from the Robinson-Patman Act, Sections 2 (d) and 2 (e), which in summary states that it is illegal to provide supplementary services to a buyer or to make allowance for services rendered by a buyer unless such concessions are equally available to all buyers.

[34] The *Grand Union* case involved disproportionately high utilization by the large Grand Union supermarket chain of a prominently displayed electric sign for advertising in relation to what it had paid relative to other retailers who had also paid to participate in the sign advertisement. Anniversary sale cases involved the method by which large retailers sponsoring special promotional bargain sales in connection with celebration of some milestone day in their business history put pressure upon their suppliers to give them special advantageous promotional allowances. In the 'Chain Lightning' cases, the three major networks negotiated contracts with a number of retail grocery chains whereby the broadcasting companies agreed to furnish radio time or television time of a stated value to each grocery chain each week during the time of the contracts, in consideration, each chain agreed to conduct in its stores a number of promotional displays for certain products to be agreed upon with the respective broadcasting companies. The broadcasting companies then solicited and obtained contracts from approximately 100 suppliers of products sold in grocery stores to purchase broadcast time and, as an added incentive, offered in-store promotion of the suppliers' products. The Commission issued cease and desist orders in seven cases, charging that the payments by the suppliers were made for the benefit of the retail grocery chains in consideration for in-store promotion, and similar benefits were not made available on proportionally equal terms to other customers who competed at retail with the favoured chains. *See* Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behavior of Food Retailing*, January 1966, pp. 195–200.

[35] Such proposals have dealt with in-store promotional gimmicks like background music with commercials, rental of store wall space for projection of pictures, rental of cubes of air space in stores for three-dimensional signs, leasing space on shopping carts, aisle end displays, recipe books or cards in display racks located near promoted ingredients, self-locating shopper guide maps, jigsaw puzzles of brand name products redeemable upon completion, and such novelties as an 'advertising scale' whose mirror is transformed into a visual sales message when the scale is activated, and a device which emits a recorded sales message when activated by a proximity switch. Several proposals related to the use of other advertising media such as magazine inserts, television advertising time, and outdoor animated billboards.

[36] Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behavior of Food Retailing*, op. cit., p. 176.

[37] The Wheeler-Lea Amendment of 1938 elaborated on Section 5 of the Federal Trade Commission Act and forbade deceptive acts or practices in the sale of goods in general, not just when there was damage to competition. Thus it plugged a legally established loophole in the original FTC Act by which the Commission was denied the right to protect consumers against misrepresentation when it was the general practice in a trade, so long as that practice did not injure competition. See also Clair Wilcox, op. cit., p. 598.

[38] New York City already has in effect for some retail items the requirement that the unit price—price per ounce, price per foot—be posted on an item in addition to its total price, thus allowing consumers to convert to a comparable basis the many different prices, brands, and container sizes with which they are faced. For a statement of the advantages and disadvantages of unit cost pricing, *see* Mary Gardner Jones, 'Comments on a Proposal for Unit-Cost Pricing,' before the New York City Department of Consumer Affairs, 26 May 1969.

some anti-trust agencies in other countries.[59] In general one can say that rather than attempting to scale down the level of non-price competition, American policy in this area has emphasized measures to remove the trade restraints and deceptions which inhere in some of these forms of non-price competition and their practice, and to see that small businessmen are not disadvantaged by such forms of promotional expenditure.

2 *Regulation of price competition: price discrimination*

The third area in which anti-trust policy toward food retailing has committed its resources is the area of assuring that the pricing behavior of food retailers is consistent with competitive performance. This resource commitment has centered on action taken against price discrimination under the Robinson–Patman Act.[60]

The law against price discrimination owes its historic origin to the prevalence of this type of conduct in the food retailing industry. Passed in the 1930's, the law against price discrimination was an attempt to cope with the discriminatory buying advantages which the large national supermarket chains, such as A and P were able to obtain over the smaller local independent retailers, including the small, family-owned enterprise, the so-called mom-and-pop stores.[61] The law took the form of a prohibition on price discrimination where the effect might be substantially to lessen competition. The law condemns both the giver of such discriminations, as well as the recipient when he induces them. Exempted are discriminations which are given in good faith to meet the equally low lawful price of a competitor, and discriminations which are based upon differences in cost of serving the favored and unfavored customer. The law also condemns as illegal brokerage payments when they are a fictitious charge rather than a charge for actual services performed.[62]

The law as passed was sufficiently general that it was left to the Commission and the courts to elaborate more specifically on the meaning of the various provisions as they affected food retailing as well as other segments of the economy, i.e. what constituted 'injury' to competition; what was a legitimate cost justification for discriminatory prices; what were the permissible limits of the good faith defense. It also left to the courts and the Commission a specification of particular criteria for the law's applicability. It was the Commission and the courts which shed light upon the status under the Robinson–Patman Act of selling private and brand label products at two different prices; as well as upon the question of the conditions under which large powerful buyers, such as the food retailing chains, violated the law when they obtained special discriminatory price or promotional allowances from suppliers.

The criteria, developed by the Commission and the courts in litigation, for injury to competition distinguished between two kinds of injury: injury to primary line competition—suppliers of the product in question who did not or could not give discriminatory prices; and injury to secondary line competition—competing customers who did not receive the benefits of the discriminatory price.[63]

As a basis for finding injury to primary line competition, the courts and the Commission, according to two recent decisions, have put forth two tests, one behavioral and the other structural, either of which seems to satisfy the criteria for primary injury. The behavioral test finds primary line injury upon demonstration of predatory intent on the part of the giver of the discriminations, as shown by price discriminations so deep and so repeated and business activity so aggressive that the behaviour goes beyond the bounds of hard driving business tactics in the context of a particular market.[64] The structural test is based upon an anlysis of what happens to the structural conditions of competition in relevant markets as a result of the discrimination, i.e. whether entry barriers are raised or concentration is increased in such a way that we can reasonably predict anti-competitive consequences.[65] In connection with this market structure test, the courts have indicated that they are not concerned with mere shifts of business between competitors, but rather with the impairment

59 For instance, the British government made Unilever and Proctor and Gamble establish alternate unadvertised brands of soap and detergent products 'of comparable quality' at prices 20 per cent below those charged for advertised brands; and on its name brands made the firms freeze prices for a fixed period. *Source: Advertising Age*, 15 May 1967.

60 Even though the majority of anti-trust enforcement resources with respect to pricing behaviour have been committed to the discriminatory pricing area, extensive action and investigation has also been taken against predatory pricing below cost selling and price fixing. Perhaps the prime example is a criminal anti-trust action against a major food chain, *US v. Safeway Stores, et al.*, Criminal Action No. 9584, Information filed 1 November 1955. Safeway's alleged predatory price wars and below cost selling made it the subject of a consent decree whereby it was enjoined from using price as a predatory tool. Moreover, substantial fines were imposed on Safeway, and individual defendants were given suspended jail sentences.

Because these areas of predatory, fixed and below cost prices are mainly within the jurisdiction of the Justice Department with its ability to exact criminal penalties, rather than under the jurisdiction of the Commission, I shall confine my remarks on pricing behavior to the area of primary interest to me as a Commission enforcement official, and the area which has consumed more enforcement resources with respect to the pricing behavior of the food retailing industry, i.e. the area of discriminatory pricing.

61 *See* Wilcox, op. cit., pp. 57–8; also Adelman, op. cit.

62 Discrimination by a seller in the absence of cost justification or good faith meeting of competition is condemned by Section 2 (a) of the Robinson–Patman Act; knowingly inducing or receiving a discrimination is condemned under Section 2 (f); Section 3 of the Act condemns giving larger discounts to some buyers than to others buying the same goods in the same quantity, or the charging of lower prices in one locality than in another; Section 2 (c) of the Act makes it illegal to pay a broker's commission if an independent broker is not employed.

63 There have been additional cases distinguishing the criteria for tertiary and fourth line injury, but these are specialized situations which are not of significant interest here.

64 *Utah Pie Co. v. Continental Baking Co.*, 386 US 685 (1967).

65 *National Dairy Products Corp. v. FTC*, 412 F.2d 605, 612–13 (7th Cir. 1969). See also previous Commission decision therein: *National Dairy Products Corp.*, FTC Docket No. 8548 (28 June 1967), and separate statement of Commissioner Jones therein.

of the vigor or health of the contest for business, regardless of which competitor wins or loses.[66]

As a basis for finding injury to competition at the secondary or customer line, the courts have adopted a stance whereby the mere existence of substantial price differentials between purchasers who compete in an atmosphere where price of the product in question is an important dimension of competition is sufficient to yield the inference of injury. The test comes close to a per se test of secondary line injury, since evidence of actual injury to given parties need not be demonstrated, and since the quantitative amount which is a measure of the injury in question need not be an amount which is essential to competitive survival. The *Foremost Dairy* decision summarizes the secondary line injury criteria as follows:

> . . . where the record indicates a price differential substantial enough to cut into the purchaser's profit margin and discloses a reduction which would afford the favored buyer a significant aggregate saving that, if reflected in a resale price cut, would have a noticeable effect on the decisions of customers in the retail market, an inference of injury may properly be indulged. It is unnecessary that there be evidence that the favored customer actually undersold his rivals, a substantial price advantage can afford a favored buyer a material capital advantage by enlarging his profit margin in a highly competitive field or it can enable him to offer customer-attracting services which will give him a substantial advantage over his competition.[67]

The courts have also elaborated on the elements which are necessary to establish a cost justification or good faith defense.

The criteria for demonstrating that alleged discriminatory discounts are cost justified are very strict ones. According to *Morton Salt*, one must demonstrate more merely than that the cost differences of serving [illegible] quantitative cost demonstration, based on a consistent and realistic set of assumptions as to the method by which individual elements of cost are allocated. The Commission will accept a defense based upon discounts for large volumes handled, or discounts based on limited versus full service distribution, but the justification must be supported by quantitative data and consistent and realistic rationale.[68]

Recent decisions have condemned the cost accounting system by which the individual stores of large multistore national or regional chains are lumped together for purposes of determining the cost savings entitling them to a cost justification defense based upon volume discounts. Where the amount of the aggregated purchases bears little or no relationship to the actual selling costs incurred as a result of the services performed, and where those selling costs vary with the volume delivered to each store, such a system of lumping together the purchases of individual stores or multi-store chains has been called inherently discriminatory.[69]

The good faith defense recognizes that a competitor, in order to keep his business may have to compete with another competitor's price by lowering his own in a specific ad hoc market situation, and that in so lowering his own he may be discriminating against some of his other customers in markets where the initiating lower-priced competitor is not present, and where a lower-priced meeting response is not required. Under such circumstances the law permits discriminatory prices which meet but do not beat the lawful price of a competitor. To be eligible for the good faith defense, a businessman must be able to show that the price situation in question was a temporary one, to which he was responding on an ad hoc basis and not part of a systematic pricing scheme. He must be able to show that as a reasonable businessman, he had no cause for belief either that he was beating a competitor's price or that there was anything to put him on notice that [illegible]

The Commission and the courts have also elaborated on other criteria for the law's applicability with special reference to food retailing

For instance, the Commission has held that nationally advertised brands and private label products which are chemically identical as to contents but differ as to labelling and advertising are to be considered of like grade and quality for purposes of assessing discriminatory behavior. For a firm to sell private label at low prices, and make it available only to some brand-label customers while withholding it from others, constitutes discriminatory behavior and competitive injury to those retailers unable to offer the lower priced private label as a competitive alternative to the higher priced national brand.[71]

Likewise the courts and the Commission have

66 *Anheuser-Busch v. FTC*, 289 F 2d 835 (7th Cir. 1961).
67 *Foremost Dairies, Inc. v. FTC*, 348 F.2d 674 (5th Cir. 1965), *cert. denied*, 382 US 959 (1965). Similarly the *United Biscuit* decision found injury despite the very small size of the dollar discounts earned by those customers granted even the maximum discount [*United Biscuit Co. of America v. FTC*, 350 F.2d 615 (7th Cir. 1965), *cert. denied*, 383 US 926 (1966)].
68 *FTC v. Morton Salt Co.*, 334 US 37 (1948).

69 In *US v. Borden Company*, 370 US at 475, it was pointed out that 'where centralized purchasing for many stores takes place, the costs of dealing with the group as a class become relevant to the problem under Section 2 (a) But where, as here, no centralized purchasing is involved, the store-by-store costs are the only criteria relevant to the 2 (a) problem. Otherwise those with the most prestige get the largest discounts and the independent merchants are more and more forced to the wall.' See also *National Dairy Products Corp.*, CCH Trade Reg Rep. Transfer Binder, 1965-7, ¶17,656.
70 Relevant Commission and Court decisions on the good faith defence are. *FTC v. Sun Oil Co.*, 371 US 505, *Continental Baking Co.*, 63 FTC 2071 at 2163 (1963), *FTC v. Standard Oil Co. (Indiana)*, 355 US 396 (1958), *Standard Oil Co. (Indiana) v. FTC*, 340 US 231, and *Standard Oil Co. (Indiana) v. FTC*, 173 F.2d 210 (1949).
71 The court on remand stated that the injury from the discrimination was mitigated by the fact that the heavily advertised nature of national brands bestows additional value on them in the eyes of consumers, so that the injury to firms deprived of being able to sell the lower priced private label alternative which was of like grade and quality is less than it would be if private label was considered by consumers to be the same good as national label. *Source*: *FTC v. Borden Co.*, 383 US 637 (1966) and Fifth Circuit's decision on remand, *Borden Co. v. FTC*, 381 F 2d 175 (5th Cir. 1967).

specifically addressed the question of Robinson–Patman liability of the large powerful buyer, such as the food retailer, who 'induces' discriminations. The criterion here seems to be something more than simply saying 'I want the best price', but need not go so far as outright coercion. Under most circumstances, so long as one of the Robinson–Patman defenses (good faith or cost justification) is available to the seller or as long as the buyer has no reason to believe that one of these defenses is not available to the seller, he is not liable under the 'inducing' Robinson–Patman discrimination provision. Thus the mere fact that a buyer obtains a discrimination and knows it is a discrimination is not sufficient to convict him; he must have reason to believe that no legitimate defense (either good faith or cost justification) is available to the seller.[72]

The Federal Trade Commission, charged with enforcing the statute prohibiting price discrimination, has devoted approximately 27 per cent of its restraint of trade resources for formal litigated matters to discriminatory preferences affecting retail food distribution.[73] The cases have involved either large suppliers actively soliciting the business of key large chain retailers by use of the 'carrot' of unlawful discriminatory preferences, or power-buying customers soliciting the discriminatory preferences, with suppliers yielding to their demands in order to retain their patronage.[74]

The law and its administration have been subject to severe criticism almost from inception, but especially recently.[75]

The most serious criticism levelled against the law is a general one that it protects a privileged group of select, small inefficient businesses against the rigors of competitive markets, where discriminations represent not predatory behavior but rather simply the workings of competition exerting pressure for lower prices. In this connection, it is said to prevent lower prices from being passed on to consumers.

By tending to identify price discriminations simply with price differences, and to rigidify the requirements of cost justification, and by introducing the necessity for a defendant firm to incur large legal and accounting expenses in a cost justification legal proceeding, the Robinson–Patman law and its administration is said also by critics to discourage sellers from passing on cost savings to buyers through experimenting with possibly more efficient methods of integrating wholesale and retail distribution functions. In so doing, it is alleged that it has worked against the very small businessman whom it is designed to protect, as for instance when he has tried to form cooperative buying groups in order to perform distribution functions which his previous small size as an individual dictated that he buy from an already existing wholesaler.

The Robinson–Patman law and its administration is also accused of fostering collusive and anti-competitive practices by foreclosing as illegal the experimental price concessions or secret reductions which an oligopolist may employ (and which indeed may be the only means which he can employ) to break out of an interdependent pricing arrangement with his fellow oligopolists. Further, by requiring proportionally equal treatment in certain promotional practices, the law is said to have discouraged experimentation with price cutting methods which are equivalent to desirable types of price differentials, such as cents-off or two-for-one promotions.

The law is also said to have caused in some instances structural harm to competition by promoting vertical integration among firms as a means of eliminating the law's requirements in their buying or selling practices; and by impeding new competition through eliminating initial discrimination as a vehicle by which a new or potential entrant can gain access to

72 *Automatic Canteen Co. v. FTC*, 346 US 61 (1953). A recent opinion re power buying on the part of a large chain customer has held, however, that the availability of the good faith defense to the supplier or seller does not automatically inure to a large power buyer who can obtain discriminatory prices in a competitive bidding situation where, through his position as a large power buyer, he obtains not only the good faith price which meets a competitor's price, but also the competitor's price which is met as well. The Commission held that it would make a mockery of the act if a large buyer such as a chain retailer could be exempted from 'inducing' a discriminatory price simply because the last discriminatory price he induced in a bidding situation where the last bidder put in a good-faith bid to win the business happened legalistically to match the previous price which as a power buyer he had also induced. *Source:* 'Opinion of the Commission', *In the Matter of Beatrice Foods Co. and The Kroger Co.*, Docket No. 8663, 1969.

73 Total investigations by the Commission into matters which include competitive injury or allegations of competitive injury to food retailers as a result of discriminatory preferences granted by grocery manufacturers number over 1,300.

Each of the nine largest corporate grocery chains of 1963, with annual sales ranging from $700 million to $5·2 billion, were cited as recipients of unlawful discriminatory preferences from suppliers in a total of thirty-four instances in sixteen separate cases in which orders to cease and desist were entered between 1954 and 1966. Eight of these same nine top grocery chains are mentioned as recipients of unlawful preferences from suppliers on thirty-one occasions in twenty-four separate complaints, which subsequently were settled by consent order procedure. (Consent orders are entered into pursuant to the Commission's settlement procedure and customarily recite that 'the agreement is for settlement purposes and does not constitute an admission by respondent that it has violated the law as alleged in the complaint'.) Three of the remaining top twenty corporate grocery chains, with annual sales ranging from $400 million to $500 million were cited as recipients of illegal preferences from suppliers on three separate occasions. Eleven corporate grocery chains with sales ranging from approximately $50 million to approximately $200 million—a range which includes approximately thirty corporate chains—were cited as recipients of unlawful preferences from suppliers on seventeen occasions in fourteen cases; and six of these same smaller corporate grocery chains, plus one other company, were named as recipients of unlawful preferences in sixteen formal complaints which were settled by the consent order procedure.

74 Staff Report of the Federal Trade Commission, *On the Structure and Competitive Behavior of Food Retailing*, op. cit., p. 186.

75 Three Presidential fact finding groups have reported a need for reappraisal of Robinson–Patman policy. [*See* Cabinet Committee on Price Stability (Willard Mueller, Chairman) *Report*, Washington DC Government Printing Office, 1969; White House Task Force on Anti-trust Policy (Phil C Neal, Chairman) *Report* 5 July 1968; Task Force on Productivity and Competition (George J Stigler, Chairman) *Report*, 1969.] Such a need for reappraisal has also been focused on in Congressional hearings of the House Small Business Subcommittee to determine whether the FTC needs greater legislative or administrative impetus to enforce the Robinson–Patman law.

The criticisms which follow represent a distillation of a large anti-Robinson–Patman literature.

an established oligopolized market or overcome the inertia of established trade relationships.

In emphasizing market conduct rather than market structure, the law and its administrators have been [illegible] size and concentration of power buyers' industries—undisturbed.

The brokerage provision of the Robinson–Patman law has also come under attack. By prohibiting sellers from paying brokerage to customers or their agents, critics have accused the law of erecting an artificial protective barrier around independent brokers, and [illegible] that price discriminations can do serious structural damage to the industry in which they occur as well as to other industries affected by them. By giving large firms an advantage over smaller firms, discrimination can be the source of predatory or exclusionary tactics [illegible] tration and damage to market structure and competition.[76]

While the Commission in the past has brought and successfully litigated cases where the economic damage to market structure was minimal, and where one or more of the above criticisms may well have been apt, it has attempted more and more in its most recent enforcement to focus on those cases which involve the actuality or likelihood of structural damage to competition, trying to protect competitors only where their preservation is essential to competition itself.[77]

We do not know the extent to which post-World War II increases in market concentration may be due to discriminatory advantages received by large buyers or sellers or how successful Commission action has been in alleviating the anti-competitive damage to [illegible] discriminations which have come to the attention of the Commission often are extremely difficult or even impossible to deal with under existing law, since the firm in question can plead the good faith argument that it was simply meeting a competitive price,[78] or that it was not engaged in the interstate commerce, which is a pre-requisite to anti-trust jurisdiction.[79]

One problem with assessing the importance and effectiveness of anti-trust policy in this area is that, since the discriminations uncovered by the Commission seem to recur again and again in the same industries (such as the dairy and bakery [illegible] foreclosed by anti-trust, this structural imbalance might be expected to manifest itself in other kinds of anti-competitive conduct. For instance, one does not and perhaps cannot know the extent to which an aggressive anti-trust posture aimed at discrimination has facilitated the growing trend toward vertical integration by retailers in the dairy and bakery industries, and thus put an increasingly observed competitive squeeze upon the middle-tier firms in these industries and solidified the market power of the largest firms who have the greatest staying power.[80]

Nevertheless, even if an aggressive posture toward price discrimination does not always get to the core of what is causing the conditions conducive of the existence of such discrimination, such a posture does make one less anti-competitive option open to large retailers and thus removes one more barrier-to-parity of the smaller independent.

More recently, the Commission, acting on the basis of its consumer protection authority, has turned to the question of evaluating what is in effect discriminatory conduct towards consumers, particularly to low-income consumers in the inner-city ghettos of the United States. While the anti-trust laws do not condemn discriminatory prices charged to consumers, the Commission's jurisdiction over deceptive and unfair acts and practices could in a proper case reach this type of practice. In its opinion in the *New York Jewelry* case, although not addressed to the food retailing industry, the Commission in the course of its opinion, scored the abnormally high mark-up policies of a general merchandise retailer doing business with primarily low-income consumers as 'unconscionable'.[81] In addition, the Commission has recently completed two comparative studies of retailers' sales practices in the ghetto. One of these was directly concerned with the practices of large food chain retailers which frequently manifested

[76] Joe S Bain, *Industrial Organization*, 1959, p. 337.

[77] A recent unpublished study by Professor Robert C Brooks, Vanderbilt University, has found that no cases have been brought under the Robinson–Patman Act from 1 January 1962, until mid-1969 which have been based simply upon price differences among customers and mere diversion of business from competitors of the discriminator. Brooks found all cases involved either findings of a tendency toward substantial reduction in number of competitors in the market, findings of a tendency to hamper or suppress increases in degree of competition, barriers to entry, foreclosure of substantial parts of a market, or lack of competitive behaviour in the market. Or else the cases included findings which show that the price discrimination affected relative success in the competitive struggle between the favoured and disfavoured groups of customers, though it was unclear what the precise effect on market competition was.

[78] *Beatrice Foods Inc., et al.*, Federal Trade Commission Docket No. 7599, Commission decision 29 July 1965.

[79] *Borden Company*, Federal Trade Commission Docket No. 7474 (1964) set aside by *Borden Company v. Federal Trade Commission*, 339 F 2d 1953 (7th Cir. 1964). That the product traded be involved in interstate commerce is a requirement of all the US anti-trust laws administered by the Justice Department and the Federal Trade Commission.

[80] The Commission has ordered the staff to prepare a plan for an overall industry investigation of the structural and behavioral characteristics of the dairy industry, with a view to re-assessing its significance for anti-trust purposes.

[81] *In the Matter of Leon A Tashof, individually trading as New York Jewelry Co.*, Docket No. 8714. Opinion of the Federal Trade Commission, 2 December 1968.

themselves in higher prices being charged in stores located in low-income areas than in higher-income areas and in a lower degree of availability of advertised specials in low-income stores.[82]

Thus price discrimination has been addressed under two enforcement statutes: discrimination against competing firms under the formal anti-trust mantle of the Robinson-Patman Act, and discrimination against consumers under the Commission's consumer protection authority.

IV Summary and conclusions

As with any set of policies toward an entire industry,[83] it is difficult to appraise whether the extensive policy reviewed here has achieved what it has set out to achieve. However, we can make some generalized observations about the anti-trust enforcement efforts described above.

1 Mergers among the largest chains have been slowed to a virtual halt, and rechannelled toward medium and smaller firms.
2 Trading stamp and games of chance; regulatory actions are too recent to afford time to appraise what effect, if any, they have had on non-price competitive strategies.
3 With regard to the strict rules regulating advertising and promotional allowances, it is known that they are complied with so that presumably more retailers are being invited to participate in such programs. Again there has been no time to ascertain whether, as critics have charged, these guides have resulted in the cancellation of promotional allowance programs by some companies. Nor is it yet known whether they have resulted in the inclusion of some retailers in these cooperative advertising programs who had formerly not been included.
4 Anti-trust enforcement has become much more aware of the possible structural barriers to competition posed for smaller local chains by the existence of large shopping centers, which have become increasingly institutionalized as the vehicles for retail trade in the United States, and whose developers may prefer the large established national chains to occupy the scarce available space in the centers. It is likely that this development will warrant additional attention in the future.

What is quite clear is that an industry such as food retailing, to which so many enforcement resources have been committed, needs a periodic policy re-examination in light of possible changes in the structural and behavioral variables affecting its competitiveness. Such a re-examination as is occurring now with respect to food retailing merger policy and the impact of price discrimination law enforcement on competition should reveal whether there is a need to modify present policy.

Absolute certainty in policy making is of course of necessity non-existent. Nor can complete empirical data ever be available in such form that policy makers can be definitive as to the effectiveness of their decisions and their value over alternative courses of action not selected.[84] Irrespective, however, of the deficiencies of existing measuring techniques, I am convinced that the anti-trust enforcement programs directed to the food retailing industry on balance have been effective and have promoted a healthy competitive structure.

82 See Report of the Federal Trade Commission, *Economic Report on Installment Credit and Retail Sales Practices of District of Columbia Retailers*, March 1968; and Staff Report to the Federal Trade Commission, *Economic Report on Food Chain Selling Practices in the District of Columbia and San Francisco*, 1969.

83 Expansion of this paper would indicate that the Commission and Justice Department have attacked mergers and inducement of discriminatory preferences on a significant basis in other service and retailing industries besides food retailing, e.g. general merchandise retailing.

84 Because any set of policies must of necessity focus on certain aspects of structure and behaviour to the exclusion of others, the policy maker can never really know, and economic analysis can give him only partial knowledge in its present state, whether he has focused on the structural and behavioral variables which are most crucial for assuring maximum competitive performance. Further, because there are so many weapons in the anti-trust arsenal, the policy maker can never be really sure he has selected the most efficient or appropriate ones to achieve desired competitive goals. In another context, this point has been illustrated by the controversy surrounding anti-trust enforcement policy in the cement industry. The policy is based on an economic analysis indicating that vertical integration leads to anti-competitive results and should be proscribed while criticism is based on the view that such vertical integration leads not to anti-competitive consequences, but rather to greater efficiency and lower prices for consumers.

Closing speech

E Dell, MP

Ladies and gentlemen, I should like to thank each of the Chairmen of the five working groups for their clear and informative reports of the discussion in their groups. They have my admiration for the way in which they have distilled into such concise statements the contents of twenty-two papers and some twelve [illegible] mand of the Canadian.

It is clear from the Chairmen's reports that a good deal of light has been thrown on all of the problems we had in mind when we devised the subjects for working groups and on a number of others besides. I take this not as a reflection on our inability to think of everything but as a compliment to our success in devising [illegible] like in this closing speech to refer to just one or two points

The object of a Conference such as this is the [illegible] countries can now unreservedly persuade their legislators to implement. This is the problem of government: from among all this wisdom, governments have to pluck those segments of more or less consistent doctrine that seem to them appropriate to their own national circumstances. Once they act, they become sitting ducks for criticism from the protagonists of all that wisdom which apparently they have ignored.

The dilemma was admirably brought out, I thought, if I may pay such a lavish tribute to a political opponent, by Mr John Davies during his speech on Wednesday. At one moment we seem to be in the presence of one of those simple lights that, if discoverable, can be such valuable guides in life. For example, Thou shalt not covet thy neighbour's wife. He illuminated the great god profit for our admiration and the conference must momentarily have thought that here at last was the key Indeed, I know of no-one who doubts the importance of the profit motive as a generator of wealth But the searchlight had not been brought for one moment on the god profit before Mr Davies told us, very properly, that the accumulation of wealth was not the principal object of national policy, it was only a principal objective, there were parallel political, moral and cultural objectives. The light faded, we were back in the old business of attempting to reconcile one objective with another

Indeed there are many conflicting objectives. It seems that the title we gave for the subject of the first group may have begged an important question by assuming that the purpose of competition policy was to promote the ultimate objectives of economic policy But a number of participants have put the different viewpoint that competition policy should also have social objectives in preventing the excessive accumulation of power in too few hands, in promoting the interests of small businesses with their distinctive social contribution and in preserving the variety of goods and services available to the consumer

Some argue that certainty in the operation of the law is a good in itself and should be sought even at the cost of flexibility Others argue that particularly in this field, certainty is virtually unobtainable and that in any case in economies of the size, for example, of the United Kingdom, an approach to greater certainty could be made only at the cost of major economic objectives, such as the achievement in our industry of greater economies of scale in production, marketing and research and development. The problem of conflict of objectives also arose, although perhaps less strikingly in the work of the fifth working group on the role of competition policy in distribution There was general agreement that, so far as it goes, legislation against such restrictive practices as resale price maintenance and refusal to supply has an important part to play in improving efficiency. But it has been pointed out that in most countries there is [illegible] legislation on restrictive practices, whereas [illegible] provisions on the concentrations of market power [illegible] not apply with equal rigour to the [illegible] One view expressed was that distribution [illegible] naturally to retain a relatively [illegible] and restrictive provisions on [illegible] sary. On the other hand, it was a [illegible] growing strength of large [illegible]

Edmund Dell, MP, at the time of the Conference was Minister of State at the Board of Trade

enabled them to exert too much pressure on their suppliers with the result that they are attaining a stronger competitive position than economic efficiency alone merits, and when the interest of the consumer is also considered, the matter is complicated further.

In an ideal world, the consumer would have the greatest possible choice available at the lowest possible price with the most convenient possible location, but in practice these are not wholly compatible objectives and competition policy and distribution must reflect the relative importance to attach to each of them.

Not only are there conflicting objectives but also there are different approaches and different systems of competition policy in the countries represented here. The fourth working group heard Dr Kristensen in his opening address pose the important question whether the time is not coming, or has not come, when business has assumed such an international character that it is inevitable that there should be greater co-operation between countries in the operation of competition policy. This suggestion has been made not only from the standpoint of governments, who might fear that international companies might otherwise effectively escape the control of national legislation, it has also come from representatives of international companies who find the diversity of the legislation to which they must conform tiresome at best, and at worst, see a danger that they may be faced with irreconcilable obligations under the competition legislation of different countries. The problem is not met by the present arrangements for the mutual notification of cases of interest to other countries. To meet this point, one would require the modification of sincerely held views about the extent of national jurisdiction over companies resident and normally operating abroad. But such modification is unlikely except in the context of much greater harmony in the content and application of legislation on competition, and this will not be easy. There are great differences in the extent and rigour of competition legislation even among OECD countries. To some extent these are historical and political in origin, but there are also substantial reasons of economic self-interest why countries of different size and types of economy should adopt different competition policies.

I would certainly hope that the United Kingdom will take part actively in the search for new procedures for handling potentially difficult cases, but equally one cannot conceal the fact that in the past different countries have adopted different approaches for what seemed to them good reasons.

Thus there are conflicts of objective, some of them operating frustratingly in the international arena. But equally there is doubt about the actual effect of policy in this field. For example, one point on which the second working group seemed to have agreed is the extreme difficulty in isolating the effect of competition policy and legislation from all the other influences on company behaviour and the extent to which the real impact of competition policy is felt not through overt action against companies but as a result of companies' disinclination to lay themselves open to any risk of anti-trust action. Those whom I might call the optimists have maintained that at any rate to an important extent the response of firms to tough competition policies is to seek to achieve their profit objectives by more dynamic and economically efficient means. The pessimists, if I may call them that, have argued that a more usual result is merely to distort the forms which uncompetitive or anti-competitive behaviour takes. It has been pointed out that information agreements or horizontal mergers may follow action against cartels but vertical integration may follow action against exclusive dealing, and the conglomerate or international mergers may have followed action against horizontal mergers. It is true that even in such cases the new structure may well be more efficient or less proof against competition than the old, but it may not: there has also been discussion of the response to legislation which is directed at the behaviour of firms rather than the structure of the industry. It has been suggested that the mere passive avoidance of anti-competitive behaviour in a structurally uncompetitive situation is not a result which the authorities can view with much satisfaction.

The third working group was given some most interesting findings on the relationship which may exist between firm size and industrial structure, on the one hand, and the rate and quality of innovation on the other. There are certainly some industries which must be regarded as special cases, particularly those deeply involved in government research and development, and these may be becoming more common and setting a pattern. For the evidence has suggested that both the view that competition is an essential stimulus to innovation, and that great size is an essential precondition, are oversimplified. It was maintained that while large but not necessarily very large firms make an important quantitative contribution to innovation, the qualities of contribution of smaller firms remains unexpectedly great. One possible explanation put forward was that the bureaucratic organization of research in some large firms is not well fitted to producing major innovations.

It was an eminent President of Harvard who suggested after the war that the organization of science had graduated from that of an Early Church, dependent on individual inspiration, to a fully modern hierarchy with every significant laboratory under the command of the scientific equivalent of a bishop, not a Lord Spiritual or Temporal but a Lord Physical or Chemical. Evidently in fact the parish priest has still a role to play. I cannot say what conclusion is to be drawn from this about competition policy; it is merely one further example of the uncertain consequences of policy and the conflicting considerations which influence policy. With all this uncertainty, is action worthwhile? Only on the assumption that, however uncertain its consequences may be in detail, some degree of control in the interests of preserving competition is better than no control. Even businessmen, with their well-known antipathy to government interference, believe that government must, as a minimum, hold the ring, though they do not unanimously or clearly define what ring it is governments hold. But when even the prophets of profit tell us that government must also have regard to political, moral and cultural objectives, at least one battle can be regarded

as having been won. It may well be arguable that it is the political as well as economic objectives, the control of centres of power as well as the pursuit of economic efficiency, that should motivate competition policy. A conviction of the importance of competition for political as well as economic reasons should perhaps have the degree of priority in a government's thinking in this area that the uninhibited pursuit of profit has in the thinking of some businessmen.

Nevertheless, it was the discussions particularly in group I which showed that competition policy has important consequences for industrial efficiency and through these makes its contribution to the broad objectives of economic policy.

Of course, legislation will always be a compromise, just as industrial structures are always compromises. Legislation may attempt to compromise between certainty and flexibility, between political and economic objectives, industrial structures compromise between the advantages of economies of scale on the one hand and the need for competition on the other, noting, no doubt, the curious fact that in highly productive economies smaller firms often seem to achieve as high productivity as their theoretically more advantageously placed larger rivals.

The most important question is the way legislation operates on human beings: does it frustrate or direct, block or channel energies? It is human beings, after all, that operate legislation, just as it is human beings that operate industrial structures. Legislation and industrial structures are always inevitably behind human learning power; one of the important capacities of human beings is that of overcoming in their practical activities the inevitable defects of legislation, as of industrial structure. It is fortunate indeed that, after Parliaments have legislated and industrial structures have been created, one is still left with the ultimate causal and creative factor of our world, the human being doing his job, probably doing it well, and trying to make the framework in which he works something which will contribute to and not frustrate his wish to do his job well and with as much benefit as possible, not just for himself but to the whole community.

I would like to say in conclusion how valuable I believe this Conference has been. It has raised many questions which demand careful attention from any government which has or is contemplating legislation on competition; it is always valuable both to administrators and to others involved in day by day work on any subject to have the chance to sit back and take a broad view. This is particularly valuable when done in company with others who approach the subject from a different standpoint. Such opportunities occur all too rarely but it is quite evident, even from the short reports which the group Chairmen have given to the Conference this afternoon, that the opportunity provided this week has been seized enthusiastically. There can be few who have attended this Conference who will not leave here with a fuller understanding of their own and other countries' competition policy.

It remains for me before the Conference closes to give thanks to the Organization for Economic Co-operation and Development for [illegible]

of the Conference, to the speakers for providing such stimulating and thoughtful papers, to the group Chairmen for guiding but clearly not inhibiting the discussion, to all the participants for coming and contributing to the Conference and to King's College for providing the setting and facilities for the Conference. The Board of Trade are happy to have been associated with such a successful and enjoyable enterprise.

I now declare the Conference closed.

END OF CONFERENCE

List of participants in the working groups

GROUP 1

Chairman

Herr E Albrecht

Speakers

Professor J P Cairns
Mr Samuel Brittan
Professor T Wilson
Mr Ulf Bernitz
Professor Almarin Phillips

Rapporteur

Mr Gordon King

Other participants

Mr R M Bannerman
Professor K E Biedenkopf
Mr J B C Carr
Mr de Sousa Carrusoa
Senor M Daranas
Mr D Delay
Mr Duesberg
Mr N Eerola
Mrs K Galle
Mr F W Glaves-Smith
Mr J F Grandy
Mr P Harris
Mr D O Henley
Mr D A Hunter Johnston
Mr P John
Sir A Johnston
Professor N Kaldor
Herr W Kartte
Mr R Lamb
Mr I M Luce
Mr R R D McIntosh
Mr R S MacLellan
Professor J E Meade
Professor H W Pederson
Mr M Polanyi
Mrs Polanyi
Professor W G Shepherd
Mr A Silberston
Professor W L Snijders
Mr G Whittington
Mr Y Yoshioka

GROUP 2

Chairman

Mr D Henry

Speakers

Professor J W Markham
Mr N H Leyland
Dr W Benisch
Professor Y Kanazawa

Rapporteur

Mr D Roberts

Other participants

Mr P Antonsen
Mr C Bergwitz-Larsen
Mr A E Bide
Mr W J Brown
Miss R Cohen
Mr M F Coop
Mr Justice Cumming-Bruce
Mr J P Cunningham
Mr E Harvey
Mr H Iyori
Mr J B H Jackson
Professor Kihlstedt
Professor F Koenigs
Mrs V Korah
Mr Jeremy Lever
Mr M J Methven
Mr M Morrell
Mr J A O'Dwyer
Mr E L Phillips
Mr E L Richards
Professor E A G Robinson
Mr G V Rogers
Dr I Schmidt
Dr H Schumacher
Mr Henry Smith
Mr A Sutherland
Mr P Watts
Mr J F Wright
Professor B S Yamey
Mr J H Locke

GROUP 3

Chairman

Mr S Golt

Speakers

Professor D Turner
Professor O E Williamson
Mr C Freeman
Mr T Ikeuchi
Herr G Albrechtskirchinger

Other participants

Mr A G Armstrong
Dr H H Barnikel
Mr J Boreham
Mr D A Clark
Mr R A Clark
Mr J M Edwards
Professor H E English
Mr K D George
Mr A T K Grant
Mr H J Gray
Mr J D Gribbin
Mr K Grossfield
Mr J B Heath
Mr H W De Jong
Professor W G McClelland
Mr A L Latham-Koenig
Mr Roger Opie
Mr A J C Paines
Mr C F Pratten
Mr G B Richardson
Mr G Robinson
Dr C K Rowley
Dr F A Singer
Mr K Soderberg
Mr J A Steinz
Madame A Zisler
Mr R H Wilson
Professor Van Themaat

GROUP 4

Chairman

Dr E Gunther

Speakers

Mr H W Wertheimer
Professor H Kronstein
Mr M D Steuer
Mr J Copp
Mr W L Fugate

Other participants

Mr R L Allen
Mr R M Allott
Mrs E Boe
Mr E G C Butt
Sir John Chadwick
Mr R E Close
Professor G Curzon
Mr R M Davidson
Mr L E Edmond
Professor Corwin Edwards
Mr J J A Ellis
Mr E J Gibbons
Mr J Gilmer
Dr H von Hahn
Professor W Hug
Mr D M Jacobs
Mr R Kristnamurti
Mr E G Langford
Mr M H Legge
Signor D Marchetti
Dr K Markert
Professor C J Maule
Mr F Ohman
Mr E Persson
Mr A J Pickford
Mr R G Pritchard
Professor E Rehbinder
Professor A E Safarian
Dr J R Schaafsma
Dr D Schaub
Mr P M Schmitt
Mr P Starr
Mr R I Threlfall
Mr R Y Wakimura
Dr E Zimmerman
Mr D Ford
Mr J Houssiaux

GROUP 5

Chairman

Mr B Clement

Speakers

Sir Hugh Weeks
Sir Bernard Miller
Professor L A Skeoch
Miss M Gardiner Jones

Other participants

Miss E Ackroyd
Mr B Baardman
Mr N Banke
Professor T Barna
Mr N E D Burton
Mr E Emringer
Mr R W Evely
Sir Roger Falk
Mrs C Fulop
Mr D A Grant
Lady Hall
Mr G M Houin
Dr J Jaffe
Mr A J Kennan
Mr E G Marriott